IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
TYLER DIVISION

IN RE ELECTRONIC DATA SYSTEMS CORPORATION SECURITIES LITIGATION THIS DOCUMENT RELATES TO: ALL CASES	CASE NO. 6:03-MD-1512 LEAD CASE 6:03-CV-110 (“SECURITIES”)

AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

NATURE OF THE ACTION

1. This action is brought by the Lead Plaintiff, Department of the Treasury of the State of New Jersey and its Division of Investment, on behalf of Common Pension Fund A ("New Jersey"), pursuant to the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-4, on behalf of itself and other persons and entities who acquired the securities of Electronic Data Systems, Inc. ("EDS" or the "Company") between February 7, 2001 and September 18, 2002, inclusive (the "Class Period"). The unlawful acts and conduct alleged herein are currently the subject of a formal investigation by the United States Securities and Exchange Commission ("SEC").

2. EDS is engaged in the business of providing comprehensive information technology solutions to large companies and governmental entities, including segments of the United States Government. EDS depends primarily upon large, long-term contracts for its revenue stream, the terms of which range in length up to ten years or more. EDS typically recognizes revenue from these contracts under the "percentage of completion" method of accounting, which under certain circumstances, allows companies to record revenue as work on the contract progresses, rather than wait until the customer is billed for work performed. GAAP only permits companies to recognize revenue under this method if the company can make reasonably dependable estimates of the extent of its progress toward completion of the contract, the amount of revenues that will be earned over the life of the contract, and the amount of contract costs. Further, any losses that will be incurred on the contract must be recognized as soon as they become evident.

3. Beginning in the fourth quarter of EDS' fiscal year ended December 31, 2000, and continuing through the end of the Class Period, EDS improperly used percentage of completion accounting

to inflate its revenues by more than $300 million through a contract with the United States Navy (the "NMCI Contract"), which provided for the Company to replace a decades-old internal computer network used by the Navy and United States Marine Corps with a state of the art "intranet" over a five to seven year period. Under the terms of the NMCI Contract, which EDS valued at approximately $6.9 billion, the Navy was not required to pay EDS the full amount of the contract price until it was satisfied with the performance of the equipment and services provided. Nevertheless, EDS recognized revenue as it delivered new workstations and other equipment to the Navy, even though the equipment was defective and failed to satisfy the criteria for acceptance set forth in the NMCI Contract. As detailed in e-mail correspondence between the Navy and EDS during the Class Period, and later confirmed in Congressional hearings held in June 2002, the defects included the following: (i) no access to certain necessary software applications contained on the old workstations, thereby requiring intranet users to use two computer workstations rather than a single computer; and (ii) inadequate security for the new intranet requiring continued use of the pre-existing network. Indeed, by June 2002, EDS had recorded revenue of approximately $1.6 billion on the NMCI Contract, representing that work was approximately 23% complete. In reality, as made clear in Congressional hearings held that month, EDS had failed to meet the Navy's criteria for acceptance for even 5% of the workstations called for under the contract.

4. EDS' recognition of revenue from deliveries under the NMCI Contract, prior to Navy acceptance, violated GAAP. As the Company ultimately admitted, it suffered from significant deficiencies in its ability to estimate revenues and costs under the NMCI Contract, which precluded EDS from recognizing revenue using the percentage of completion method of accounting. Moreover, EDS' products delivered during the Class Period failed to meet the Navy's criteria for acceptance, which precluded

revenue recognition under the percentage of completion method. In addition to having to fix and rework defective products, EDS failed to account properly for the increased costs associated with curing these defects. Furthermore, in accounting for the NMCI Contract, the Company used a "zero profit" methodology, whereby EDS recognized revenues equal to costs incurred despite the fact that costs were exceeding revenues by more than $300 million due to the need to correct substantial defects in EDS' products. Defendants hid the loss throughout the Class Period. When the truth was finally disclosed, EDS recorded a loss of $334 million, or over 20% of the revenues that the Company recorded from the NMCI Contract during the Class Period.

5. EDS' overstatement of its revenues in connection with the NMCI Contract was orchestrated by defendants Richard H. Brown ("Brown") and James E. Daley ("Daley"), the Chief Executive Officer and Chief Financial Officer of the Company, respectively. Throughout the Class Period, these top officers received daily and monthly reports of the progress of EDS' major contracts, including the NMCI Contract, which was one of the largest contracts in the Company's history. Further, Brown and Daley were responsible for ensuring the accuracy of EDS' financial reporting and the adequacy of its internal controls, and filed certifications with the SEC during the Class Period attesting to the accuracy of its financial statements. Therefore, Brown and Daley either knew or, but for their severe recklessness, should have known that, as a result of the delays and cost overruns arising from the delivery of EDS' defective products and the discovery of thousands of software applications on the Navy's prior computer system which were incompatible with the new intranet, it was not permitted to recognize revenue on the NMCI Contract as work was "performed" under GAAP. Nevertheless, these top officers not only permitted EDS to continue recognizing revenue on the NMCI Contract to help meet prevailing revenue

expectations, but actually sped up the delivery of defective work product, hiding the growing losses associated with this significant engagement.

6. The public dissemination of this materially false and misleading information caused EDS securities to trade at artificially inflated levels, with its common stock reaching a Class Period high of $77.88 per share. On September 18, 2002 – merely one month after confirming its previous guidance of quarterly revenue growth of 4%-6% and earnings per share of $0.74 – EDS announced that it expected up to a $300 million decline in revenues from the same quarter of the prior year, and earnings of only $0.12 to $0.15 per share, based in part upon problems in various unspecified contracts in which the Company recognized revenue under the percentage of completion method of accounting. Although EDS did not specifically identify the NMCI Contract as problematic at that time, several investment analysts cautioned that problems with this contract were likely contributors to the shortfall. On the day after this announcement, the price of EDS common stock fell by more than 50%, from $36.46 to $17.20 per share on volume of 69.6 million shares.

7. On January 7, 2003, and March 20, 2003, respectively, EDS announced that it had removed defendants Daley and Brown from their positions within the Company. Shortly thereafter, on May 7, 2003, EDS announced that it had recorded a loss of $334 million due to problems associated with the NMCI Contract. Days later, on May 15, EDS' management disclosed deficiencies in the operational effectiveness of controls over EDS' process to estimate revenue and costs for the contract, which the Company's outside auditors deemed to be "significant." The Company's announcements concerning its revenue shortfall and losses associated with the NMCI Contract are currently among the subjects of an SEC Formal Order of Investigation.

JURISDICTION AND VENUE

8. This Court has jurisdiction over the subject matter of this action under Section 27 of the Exchange Act, 15 U.S.C. § 78aa, as well as 28 U.S.C. § 1331. The claims alleged herein arise under Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder by the SEC, 17 C.F.R. § 240.10b-5.

9. Venue is proper in this District pursuant to Section 27 of the Exchange Act, 15 U.S.C. § 78aa and 28 U.S.C. § 1391(b). Many of the acts and transactions giving rise to the violations of law complained of herein, including the preparation and dissemination to the investing public of false and misleading financial statements, occurred in this District. In addition, defendant EDS maintains its principal executive offices in this District at 5400 Legacy Drive, Plano, Texas 75024.

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

PARTIES

11. Lead Plaintiff New Jersey is a domestic stock fund created for the purpose of investing the assets of various pension plans for the benefit of over 600,000 current and retired public employees of the State of New Jersey, including participants in the following pension plans: Judicial Retirement System; Police and Firemen's Retirement System; Public Employees' Retirement System; State Police Retirement System; and Teachers' Pension and Annuity Fund. New Jersey purchased 940,000 shares of EDS common stock during the Class Period and suffered damages as a result of the violations of law alleged herein. By Order dated May 5, 2003, the Court appointed New Jersey as Lead Plaintiff in this action

pursuant to Section 21D of the Exchange Act, 15 U.S.C. § 78u-4.

12. Defendant EDS is a professional services firm that provides clients with broad categories of traditional information technology ("IT") outsourcing, business process outsourcing, solutions consulting, management consulting, and product life cycle management software and services.

13. (a) Defendant Richard Brown served as a director and Chief Executive Officer ("CEO") of EDS from January 1999, until his termination by the Company in March 2003. By virtue of his positions as director and CEO, and his day-to-day involvement in the management and operation of EDS as particularized below, Brown was a controlling person of the Company and exercised his power and influence to cause EDS to engage in the wrongful conduct complained of herein.

(b) Brown, along with defendant Daley, was responsible for ensuring the accuracy of EDS' financial reports and filings with the SEC throughout the Class Period. Brown signed each of the Company's annual reports on Form 10-K, as filed with the SEC, for fiscal years 2000, 2001, and 2002. Also, on July 26, 2002, Brown filed a sworn certification with the SEC, as required by SEC Order No. 4-460, in which he separately attested to the accuracy of EDS' reported financial results for Fiscal 2001, and for the first two quarters of Fiscal 2002. Brown also filed sworn certifications with the SEC on November 14, 2002, and March 12, 2003, in which he attested to the accuracy of the Company's financial results as reported in the Company's quarterly report on Form 10-Q for the third quarter of Fiscal 2002, and its financial results as reported in the Company's annual report on Form 10-K for Fiscal 2002, respectively.

(c) Brown also certified to the SEC on November 14, 2002, and March 12, 2003, that he: (i) was "responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for [EDS]"; (ii) designed these controls "to ensure that material information relating to the registrant . . . is made known to [him]; and (iii) had "evaluated the effectiveness of EDS' disclosure controls and procedures" within 90 days of the filing of his certification. Brown further certified that, based on his evaluation, "EDS' disclosure controls and procedures are effective," and there were no "significant deficiencies in the design or operation of internal controls which could adversely affect [the Company's] ability to record, process, summarize and report financial data . . . ." Brown also certified on November 13, 2002, and March 12, 2003, that there had been "no significant changes in EDS' internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation."

(d) Brown, along with defendant Daley, was principally responsible for the Company's communications to securities analysts and investors during the Class Period. Brown commented on the Company's financial performance in each of its earnings releases issued during the Class Period, including press releases dated February 7, 2001, April 25, 2001, July 25, 2001, October 24, 2001, February 7, 2002, April 22, 2002, and July 24, 2002. Brown also communicated directly with investment analysts concerning the Company's financial results in quarterly conference calls held throughout the Class Period, including calls held on February 7, 2001, April 25, 2001, July 25, 2001, October 24, 2001, February 7, 2002, April 22, 2002, and July 24, 2002.

(e) Brown was directly aware of the status of EDS' largest contracts, including the NMCI Contract, from a variety of sources. Throughout the Class Period, Brown received daily updates as to the status of EDS' major long-term contracts, including the NMCI Contract, and used these updates to determine the extent to which EDS was permitted to recognize revenue from these contracts under

GAAP. One of the primary tools used by Brown was EDS' internet-based "service excellence dashboard," which contained material information concerning EDS' performance covering over 90% of the Company's customers as of the beginning of the Class Period in February 2001. The dashboard also communicated contract problems to EDS' upper management through the use of a color coding system that signified the severity of the problem. Brown stated in an article issued by *Bloomberg News Service*, dated April 7, 2001, that he consulted the dashboard every day, stating further: "When I'm on the road, I call it up on laptop."

(f) Brown also received regular updates as to the status of EDS' major contracts, including the NMCI Contract, through the Company's Cost Accounting System ("CAS"), which was one of the primary tools used by EDS to determine the extent to which it had completed work on its contracts. According to a former Strategic Manager of Information Technology Services for EDS, from February 2000 through June 2002 (the "IT Manager"), EDS employees entered cost and budget information concerning the Company's contracts, including the NMCI Contract, into CAS on a daily basis. Brown received regular CAS reports, through which he knew or, but for his severe recklessness, should have known the precise costs incurred by EDS on the NMCI Contract throughout the Class Period, as well as the extent to which these costs exceeded budgeted estimates. Brown also promoted the use of the CAS system. The CAS actual results were compared to the financial projections contained in EDS' "Outlook" system, which was used to project EDS' financial position over three years. Each EDS top executive was required to use Outlook, compare actual results to projected results, and explain variances. Brown had this information rolled up by account, including the Navy account, by the seventh of each month during the Class Period. According to the IT Manager, "Outlook" was taken seriously because "we had to constantly show revenue gains."

(g) Brown also convened monthly telephone conference calls with his top executives, in which defendant Daley also participated, for the purpose of reviewing budgeted and actual results each month. During these monthly conference calls, Brown presided over a review of EDS' monthly results compared to the Company's internal budgets and projections. Approximately 150 of EDS' executives participated on these calls, including defendant Daley, Chief Operating Officer Jeff Heller, and Executive Vice President and Senior Executive for Operations Douglas Frederick. Vice Presidents and Client Delivery Executives, such as Vice President of Government Al Edmonds, and Client Executive in charge of the NMCI Contract Rick Rosenberg, also participated on these calls during the Class Period.

(h) Through his direct participation and involvement in the Company's financial reporting functions, as detailed in ¶¶13a-13g, above, Brown knew or was severely reckless in disregarding that, contrary to his representations: (i) EDS suffered from significant deficiencies in its financial reporting function that should have precluded recognizing revenue from the NMCI Contract utilizing the percentage of completion method of accounting; and (ii) the products that EDS delivered to the Navy under the NMCI Contract were defective, did not meet the criteria for acceptance under terms of the contract, and therefore should have precluded revenue recognition. Brown either knew or, but for his severe recklessness, should have known that these defects included: (i) an inability to transfer necessary software applications to new workstations, thereby requiring intranet users to use two computers rather than one to perform their jobs; and (ii) an inability to provide adequately secure access to users, thereby further undermining and delaying the transition to the NMCI Intranet.

(i) Brown also knew that, as a result of the problems described above, EDS was unable to meet the criteria for functionality established by the Navy under the NMCI Contract, which, in turn, prevented EDS from delivering more equipment. Indeed, as detailed in ¶¶96 and 98, below, Brown knew that, as of June 2002, EDS had recognized approximately $1.6 billion from the NMCI Contract, or approximately 23% of the contract's original total value, despite its failure to demonstrate the adequacy of even 5% of the new intranet. Nevertheless, on or about April 2002, Brown directed EDS executive Mike Hatcher, who served as Program Director for Navy Operating Forces during the Class Period, to accelerate the delivery of workstations despite the fact that material deficiencies had not been corrected. As detailed in ¶37, below, Hatcher, with the knowledge and assent of Brown, directed EDS to accelerate the delivery of intranet workstations to the Navy regardless of the deficiencies, as set forth in an e-mail to EDS personnel employed on the NMCI Contract: "We will set the seat rollout schedule, and everything else will be slave to that. If [software applications] are not there, they will get a vanilla NMCI seat with nothing but the gold disk. If the order is not definitized, they will get a seat type of our choosing." Brown, together with defendant Daley, then authorized EDS to recognize revenue on the NMCI Contract based upon the delivery of these defective workstations in violation of GAAP.

(j) Brown also authorized EDS to recognize revenue on the NMCI Contract before the Navy had any obligation to pay for the products, despite findings by the Committee on Appropriations of the U.S. House of Representatives, in June 2002, that the project has been "unstable since its inception," that the testing of products delivered by EDS to ensure their ability to provide the services required under the NMCI Contract had been inadequate, and that EDS' representation that the system was ready for widespread deployment was "questionable." Brown also knew that, as a result of this finding, Congress refused to authorize further orders of intranet workstations until more rigorous testing had been performed, and the defects in the products already delivered had been cured, and EDS demonstrated that 5% of the workstations to be delivered satisfied the criteria set forth for acceptance in the NMCI Contract. In fact, this testing was not completed to the Government's satisfaction no earlier than about February 25, 2003, five months after the end of the Class Period. Nevertheless, Brown continued to direct EDS to recognize revenue on the NMCI Contract before these defects had been cured, and before the Navy incurred any obligation to pay for these defective products, in violation of GAAP.

(k) On March 20, 2003 – merely eight days after Brown certified the accuracy of EDS' reported financial results and the adequacy of the Company's internal controls – EDS terminated his employment as CEO. Less than two months later, EDS announced that management had discovered deficiencies in its internal controls relating to the NMCI Contract, which its auditors deemed significant, and that the Company would record a loss from work performed on the contract to date of $334 million.

14. (a) Defendant James Daley served as Executive Vice President and Chief Financial Officer ("CFO") of EDS from January 1999, until his reassignment by the Company in January 2003. By virtue of his position as CFO, and his day-to-day involvement in the management and operation of EDS as particularized below, Daley was a controlling person of the Company and exercised his power and influence to cause EDS to engage in the wrongful conduct complained of herein.

(b) Daley, along with CEO Brown, was responsible for ensuring the accuracy of EDS' financial reports and filings with the SEC throughout the Class Period. Daley signed each of the Company's annual reports on Form 10-K, as filed with the SEC, for fiscal years 2000 and 2001, as well as its Forms 10-Q for each fiscal quarter during the Class Period. Also, on July 26, 2002, Daley filed a sworn certification with the SEC, as required by SEC Order No. 4-460, in which he separately attested to the accuracy of EDS' reported financial results for Fiscal 2001, and for the first two quarters of Fiscal 2002. Daley also filed a certification with the SEC on November 14, 2002, in which he attested to the accuracy of the Company's financial results as reported in the Company's quarterly report on Form 10-Q for the third quarter of Fiscal 2002, and its financial results as reported in the Company's annual report on Form 10-K for Fiscal 2002, respectively.

(c) Daley also certified to the SEC on November 13, 2002 that he, along with defendant Brown: (i) was "responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for [EDS]"; (ii) that he designed these controls "to ensure that material information relating to the registrant . . . is made known to [him]"; and (iii) that he had "evaluated the effectiveness of EDS' disclosure controls and procedures" within 90 days of the filing of his certification. Daley further certified that, based on his evaluation, he had concluded that "EDS' disclosure controls and procedures are effective," and that there were no "significant deficiencies in the design or operation of internal controls which could adversely affect [the Company's] ability to record, process, summarize and report financial data . . . ." Daley also certified on November 13, 2002 that there had been "no significant changes in EDS' internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation."

(d) Daley also participated with Brown in communicating to securities analysts and investors during the Class Period. Daley commented on the Company's financial performance in its press release dated July 24, 2002. Daley also communicated directly with investment analysts concerning the Company's financial results in quarterly conference calls held throughout the Class Period, including calls held on February 7, 2001, April 25, 2001, July 25, 2001, October 24, 2001, February 7, 2002, April 22, 2002, and July 24, 2002.

(e) Throughout the Class Period, Daley received the same daily updates as to the status of EDS' major long-term contracts, including the NMCI Contract, as Brown received, including reports through the service excellence dashboard, CAS, and Outlook referred to in ¶¶13f-13g, above. Daley also participated in the monthly telephone conference calls referred to in ¶13g, above, in which the Company's top executives compared EDS' actual and budgeted results.

(f) Through his direct participation and involvement in the Company's financial reporting functions, as detailed in ¶¶14a-14e, above, Daley knew or was severely reckless in disregarding that, contrary to his certifications to the SEC: (i) EDS suffered from significant deficiencies in its financial reporting function that should have precluded recognizing revenue from the NMCI Contract utilizing the percentage of completion method of accounting; and (ii) the products that EDS delivered to the Navy under the NMCI Contract were defective, did not comply with the terms of the contract, and therefore should have precluded revenue recognition. Daley either knew or, but for his severe recklessness, should have known that these deficiencies included the following: (i) an inability to transfer necessary software applications to new workstations, thereby requiring intranet users to use two computers rather than one to perform their jobs; and (ii) a failure to provide key secure website access for intranet users, thereby further undermining and delaying the transition to the NMCI Intranet.

(g) Daley also knew that, despite EDS' inability to meet the criteria for functionality established by the Navy under the NMCI Contract, the Company was accelerating the delivery of defective products to the Navy, as described in ¶13i, above. Further, Daley knew that the Committee on Appropriations of the U.S. House of Representatives had found in June 2002 that products delivered by

EDS had not been adequately tested, and recommended that further orders be halted until EDS demonstrated that at least 5% of the workstations to be delivered met the criteria set forth in the NMCI Contract, as described in ¶39, below. As set forth in ¶13j, above, this testing was not completed to the Government's satisfaction no earlier than February 25, 2003 – five months <u>after</u> the Class Period. Despite this knowledge, Daley authorized EDS to recognize revenue based upon these deliveries, even though he knew or, but for his severe recklessness, should have known that, given the Government's finding that the products delivered did not meet the requirements set forth in the NMCI Contract, revenue recognition was not permitted under GAAP.

(h) On January 7, 2003, Daley was replaced as CFO of the Company. Daley did not sign EDS' annual report on Form 10-K for Fiscal 2002, nor did he file a certification with the SEC attesting to the accuracy of the results reported therein, or the adequacy of EDS' financial controls.

15. Defendants Brown and Daley (collectively, the "Individual Defendants") possessed the power and authority to control the contents of EDS' SEC reports and filings, press releases and presentations to securities analysts and knew that such information was conveyed through the analysts to the investing public. Because of their positions within the Company, the Individual Defendants were able to and did control the contents of the various quarterly financial reports, SEC filings, press releases, and presentations to securities analysts pertaining to EDS during the Class Period.

CLASS ACTION ALLEGATIONS

16. New Jersey brings this action as a class action pursuant to Rules 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of a Class of persons and entities who purchased or otherwise acquired the securities of EDS between February 7, 2001 and September 18, 2002, inclusive, and who

were damaged thereby. Excluded from the Class are the defendants, members of the families of each of the Individual Defendants, any parent, subsidiary, affiliate, partner, officer, executive, or director of any defendant, any entity in which any such excluded person has a controlling interest, and the legal representatives, heirs, successors and assigns of any such excluded person or entity.

17. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to New Jersey at this time, and can only be ascertained from books and records maintained by EDS and/or its agents, New Jersey believes that the Class members number in the thousands. As of September 30, 2002, the Company had approximately 480 million shares of common stock issued and outstanding, which at all relevant times, actively traded on the New York Stock Exchange, an efficient market. During the Class Period, EDS was followed and reported on by analysts at numerous securities firms, including Morgan Stanley Dean Witter, UBS Warburg and Salomon Smith Barney.

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

(a) Whether the federal securities laws were violated by defendants' acts and omissions as alleged herein;

(b) Whether the documents, reports, filings, releases, and statements disseminated to the Class by defendants during the Class Period misrepresented material facts about the business, performance, and financial results and condition of EDS;

(c) Whether defendants participated in and pursued the common course of conduct and fraudulent scheme complained of herein;

(d) Whether defendants acted knowingly or with severe recklessness in misrepresenting material facts;

(e) Whether the market price of EDS securities was artificially inflated during the Class Period due to the false and misleading statements complained of herein; and

(f) Whether New Jersey and the other members of the Class have sustained damages and if so, the appropriate measure thereof.

19. New Jersey will fairly and adequately represent and protect the interests of the members of the Class. New Jersey has retained competent counsel experienced in class and securities litigation and intends to prosecute this action vigorously. New Jersey is a member of the Class and does not have interests antagonistic to, or in conflict with, the other members of the Class.

20. New Jersey's claims are typical of the claims of the members of the Class. New Jersey and members of the Class purchased or otherwise acquired EDS securities during the Class Period at artificially inflated prices and have sustained damages arising out of the wrongful course of conduct alleged herein.

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

THE FRAUDULENT SCHEME

General Background

22. EDS provides a wide-range of information technology services to large companies and governmental entities. More than 75% of the Company's revenues during the Class Period were derived from its Information Solutions line of business, through which EDS provided a wide range of computer networking and management services under contracts that range in duration up to ten years or more.

23. During the Class Period, EDS was valued within the investment community based primarily upon its ability to maintain significant revenue growth, principally through winning larger and larger long-term contracts that would guarantee a significant revenue stream into the future. Indeed, following the announcement of EDS' financial results for the third quarter of Fiscal 2000, at least one investment analyst, David M. Togut ("Togut") of Morgan Stanley Dean Witter, lowered his rating on EDS common stock to "neutral," even though the Company had exceeded prevailing earnings expectations. Togut echoed other analysts when explaining the downgrade, noting that EDS had achieved its earnings targets through cost-cutting, while revenues had fallen short of expectations.

EDS' Revenue Recognition Practices

24. EDS employed the percentage of completion method of accounting for recognizing revenue under its large, long-term contracts, which provided the means for the Company's revenue growth during the Class Period. As detailed in ¶¶46-48, below, the percentage of completion method permits companies to recognize revenue from certain long-term contracts as work progresses, rather than wait until the customer is billed. For example, if a company has completed 50% of the work required under a long-term contract, but the contract provides for no billing until the contract is 100% complete, percentage of completion accounting might permit the company to record 50% of the revenues it expects to earn over

the life of the contract, thereby offsetting the costs of performing the work already incurred. Under this method of accounting, "unbilled revenues" represent revenues the company has "earned," but for which it is not yet entitled to bill the customer under the terms of the applicable agreement. Conversely, under the completed contract method, a company recognizes revenue only when the contract is completed or substantially complete.

25. EDS' recognition of unbilled revenues through its use of percentage of completion accounting was the primary driver of its reported revenue growth during the Class Period. Between Fiscal 2000 and Fiscal 2002, EDS' unbilled revenues increased by nearly 300%, from $1.031 billion to $3.033 billion. This increase in unbilled revenues was primarily responsible for the Company's increase in revenue during the same period - from approximately $19.2 billion to $21.5 billion, or a 12% increase. Thus, if not for its inclusion of unbilled revenues, EDS' total revenues would have remained stagnant during the Class Period. As detailed in ¶98, below, approximately 60% of these unbilled revenues were derived from the NMCI Contract. Nevertheless, EDS represented throughout the Class Period that its recognition of unbilled revenue through its use of the percentage of completion method of accounting complied with GAAP, as set forth in its annual report on Form 10-K for Fiscal 2001:

> For certain unit-price and fixed price contracts, we follow the guidance contained in AICPA Statement of Position ("SOP") 81-1, *Accounting for Performance of Construction-Type Contracts*. SOP 81-1 requires the use of percentage-of- completion accounting for long-term contracts that contain enforceable rights regarding services to be provided and received by the contracting parties, consideration to be exchanged, and the manner and terms of settlement, assuming reasonably dependable estimates of revenue and expenses can be made. . . . Amounts recognized in revenue are calculated using the percentage of services completed, on a current cumulative cost to total cost basis. Cumulative revenues recognized may be less or greater than cumulative costs and profits billed at any point in time during a contract's term. The resulting difference is recognized as unbilled or deferred revenue.

26. EDS also represented, as set forth in its Form 10-K for Fiscal 2001, that it continually evaluated its estimates, judgments and assumptions based on available information and experience. As reported in the *Asian Wall Street Journal* on September 27, 2002, according to Scot McDonald, EDS' chief accounting officer, EDS examines contracts every three months to make sure estimates are on track. If the contracts are off by more than $5 million, senior executives joined the review.

The NMCI Contract

27. The Company's representations concerning the manner in which it recognized revenue under the percentage of completion method of accounting were materially false and misleading because defendants either knew or, but for their severe recklessness, should have known that due to significant deficiencies existing in the operational effectiveness of its controls to estimate revenue and costs, EDS lacked the ability to properly estimate its costs and revenues with respect to the NMCI Contract. Furthermore, as delays associated with additional testing, the discovery of thousands of pre-existing software applications that were incompatible with the new intranet, and EDS' delivery of defective products affected EDS' progress on the NMCI Contract causing increased costs, defendants knew or were severely reckless in disregarding that the NMCI Contract was generating hundreds of millions of dollars in losses which should have been recorded during the Class Period.

28. The $6.9 billion NMCI Contract, the largest government outsourcing contract in history, was awarded to EDS by the United States Navy on October 6, 2000. The contract provides for EDS to replace and link approximately 350,000 desktop computers, scattered over approximately 300 military bases worldwide into a single, highly secure intranet network over a three-to-five year period. On its website, EDS listed the award of the NMCI Contract as the fourth most significant event in the Company's

history. The price of EDS common stock rose approximately 10% on the day the contract award was announced, while various investment analysts characterized the award as dispelling doubt about EDS' ability to achieve double-digit revenue growth.

29. In reality, various severe problems infected the NMCI Contract from its inception, which should have precluded EDS from recognizing revenue from the contract under the percentage of completion method of accounting. As reported by *Business Week* on April 7, 2003, EDS arrived at its $6.9 billion bid by estimating only a 4% profit margin for the Company – nearly 43% less than the 7% margin EDS included in most of its "megadeal" contracts according to UBS Warburg investment analyst Adam Frisch. Such a low margin created a substantial risk that EDS would incur a loss on the contract from the outset, given the vastness of the undertaking and the likelihood of cost over-runs. Indeed, according to the same *Business Week* article, defendant Daley advised other EDS executives at the time the contract was awarded that EDS would likely never achieve a profit on the contract after accounting for inflation, based upon the inclusion of such a slender margin.

30. The likelihood of a loss due to the low profit margin included in the bid was exacerbated by the payment terms under the contract. Section 5.9.3.2 of the NMCI Contract provided for the Navy to pay EDS the full contract price for work performed only "[a]t the time when [EDS] meets or exceeds the service level agreements for the ordered segment," as determined by the Navy through its testing criteria. Given the small profit margin included in the contract, any unforseen problems creating delays would immediately generate a loss.

31. Even if defendants had been unaware of any specific problems at the outset of the NMCI Contract, the severe problems encountered immediately upon implementation and the significant

deficiencies in the Company's inability to estimate its costs should have precluded recognizing revenue using the percentage of completion method. For example, during the first quarter of Fiscal 2001, EDS learned that it had severely underestimated the problem of transferring "legacy software" – software applications that remained from the Navy's pre-existing computer system – to the new intranet being created by EDS. Specifically, the NMCI Contract required EDS to eliminate duplicative legacy software, and to transfer necessary programs to the new workstations. Upon commencing work at the Naval Air Systems Command in Patuxnet River, Md., in early 2001, however, EDS discovered that a substantial number of the legacy programs slated to be transferred were incompatible with the new Windows-based intranet. By 2002, according to *Business Week*, over 100,000 incompatible programs had been identified, which required thousands of intranet users to utilize two workstations.

32. Indeed, in September 2001, based upon these problems and the inability to satisfy Navy testing, the Navy deferred approximately $628 million in orders under the NMCI Contract until further testing proved successful. As a result of this decision by the Navy, EDS laid off 10% of its workforce devoted to NMCI in September 2001. In an e-mail dated May 6, 2002, Naval Air NMCI Transition Manager George Kalnasy acknowledged the persistence of the legacy software issue, assuring Navy personnel that further EDS workstations would not be delivered until the problem had been solved. Mr. Kalnasy also detailed a series of other problems in his May 6 e-mail disrupting transition to the new intranet, including the following: (i) failure to provide remote access service for 61% of the users testing this function on behalf of the Navy in various facilities; (ii) failure to provide acceptable secure web access; and (iii) failure to provide adequate "help desk" support.

33. Defendants knew of the problems pervading its progress on the NMCI Contract. In the

late Spring of 2002, the Institute for Defense Analysis ("IDA") completed its own independent testing of the NMCI project, which identified the inadequate rate of rationalization/certification of legacy applications to meet the NMCI deployment schedule as a high risk associated with the project. IDA further found that the slow rate of certification that these software applications would not interfere with other applications and that they operated within accepted security policies did not support EDS' deployment schedule.

34. The IDA also reported on the problems affecting the Enterprise Management System ("EMS"), the system enabling EDS to manage a large and complex network such as the NMCI and to automatically capture and report service level agreement performance data to the government. The IDA reported that, during testing, the "delivery and integration of EMS was continually delayed, and as the network grew, many of the management functions remained manual or semi-automated." IDA recommended that the Navy increase its monitoring of the EMS. The IDA also recommended that "the performance data being gathered by EMS and reported by the contractor [EDS] to the government be independently verified throughout the life of the contract."

35. The IDA report also stated that, while the seat roll-out process was critical to meeting the schedule for the system's deployment, the IDA found the process lacked proper management oversight, and suffered numerous problems. Specifically, "ineffective coordination of customers for delivery of desktops caused high unavailability rates (25-50 percent), and lack of product assurance process caused significant rework. As a result, the seat roll-out rate remained well below the desired 100 seat-per-day-per site rate."

36. Based on these problems, by June 2002, more than eighteen months after the Navy had awarded the NMCI Contract, EDS had failed to transition even 5% of the workstations called for under

the contract to the new intranet due to the severe functionality problems set forth in ¶¶31-35, above. Nevertheless, EDS failed to halt its revenue recognition or recognize the losses it had incurred in connection with the NMCI Contract. To the contrary, in April 2002, EDS embarked upon a plan to accelerate revenue recognition on the NMCI Contract, by speeding up the roll-out of additional equipment, regardless of the Company's inability to meet the Navy's standards.

37. On April 25, 2002, EDS NMCI Program Director Mike Hatcher sent an e-mail to EDS personnel in which he outlined a new "scorched earth policy" designed to deliver equipment to the Navy regardless of its functionality, and even in the absence of a "definitized order" from the Navy:

> [W]e have agreed with [Rear Admiral] Munns and the Navy that ruthlessly rolling seats is the only way for NMCI to survive and prosper. Gen. Edmonds characterized this approach in a meeting with RADM Munns as scorched earth seat rollout, and I think that pretty much tells the story. Our present way of working would probably only result in about 60,000 seats rolled out in 2002, which if left unchanged would spell an end to the NMCI program by summertime. We've come too far to let that happen . . .
>
> The bottom line is we're going to roll seats, and will be diverting many resources to this goal. Any obstacle that gets in the way will be crushed. No more IATO delays [i.e., certifications from the Navy that the new workstations comply with security standards promulgated by the Department of Defense and are approved to operate], application packaging delays, can't get the [applications], can't get the user-to-apps mapping, can't get the definitized order, etc. We will set the seat rollout schedule, and everything else will be slave to that. If [software applications] are not there, they will get a vanilla NMCI seat with nothing but the gold disk [i.e., the standard software installed on new intranet terminals]. *If the order is not definitized, they will get a seat type of [EDS'] choosing*.
>
> This is a good news story, and creates the breakout we've been waiting for on NMCI. Better times are just ahead!! Stout hearts . . (emphasis added).

38. The severe problems associated with the implementation of the NMCI Contract were ultimately recognized by Congress, which put a halt to EDS' attempts to continue to deliver unsatisfactory products until previously delivered equipment had been adequately tested, and pre-existing problems had

been corrected. On June 25, 2002, the House Committee on Appropriations found severe defects in the implementation of the NMCI Contract, and openly criticized EDS' representations that the intranet system was "ready for widespread deployment," instead finding that "excerpts from [EDS'] report are indicative of this questionable conclusion and clearly demonstrate the shortcomings of testing." The report further stated:

> Some business processes were not well defined for the testers, limiting the effectiveness of the scenario; other business was not fully represented in the test site population, rendering an end-to-end look impossible. Still other business processes . . . required a combination of NMCI and legacy applications, making an end-to-end test wholly on the NMCI system problematic at best. . .
>
> While independent operational test and evaluation is now planned for June 2003, it will not occur until over 75 percent or approximately 310,000 of the 411,000 NMCI seats have been ordered and at which time an estimated 100,000 seats will have been fully transitioned to the network. *If the history of this program is any indication, significant problems are likely to be discovered when the system is subjected to rigorous operational test and evaluation*. (emphasis added)

39. Based on these observations, the Appropriations Committee recommended additional orders under the NMCI Contract wait until testing confirmed that at least 20,000 workstations, or merely 5% of the number of workstations subject to the NMCI Contract, were fully operational and met functionality standards under the contract:

> The Committee believes it would be most beneficial for the Navy and NMCI if additional seat orders were delayed as part of this contract extension pending independent operational test and evaluation. Therefore, the Committee has included a general provision that prohibits the Navy from ordering additional seats above the current 160,000 authorized . . . and requires that operational test and evaluation be conducted once there has been a full transition of not less than 20,000 workstations to the Navy-Marine Corps Intranet and the network is robust enough so as to perform adequate testing. *The Committee believes that the delay in seat orders that will result will also provide the Navy and [EDS] much needed time to address the legacy application problems which will arise from the order of the first 160,000 seats.* (emphasis added)

40. Despite the costs overruns as a result of the defective products shipped and the increased delays due to additional and more stringent testing, the Company still failed to record a loss on the contract or acknowledge that its failure to meet acceptance criteria set forth in the NMCI Contract precluded further revenue recognition under GAAP. Nor did EDS disclose that its internal controls suffered from significant deficiencies that prevented it from producing reasonably dependable estimates of its revenue and costs under the NMCI Contract, which precluded the use of the percentage of completion method altogether. Approximately eleven months later, in the wake of a significant revenue and earnings shortfall, a formal SEC investigation, and the departures of defendants Brown and Daley from their positions, EDS finally acknowledged that it had incurred a loss of $334 million on the NMCI Contract.

GAAP VIOLATIONS

41. SEC Regulation S-X (17 C.F.R. § 210.4-01(a)(1)) provides that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. § 210.10-01(a). The responsibility for preparing financial statements that conform to GAAP rests with corporate management as set forth in Section 110.02 of the AICPA Professional Standards:

> The financial statements are management's responsibility . . . Management is responsible *for adopting sound accounting policies and for establishing and maintaining internal control* that will, among other things, record, process, summarize, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management . . . Thus, the fair presentation of financial statements in conformity with [GAAP] is an implicit and integral

part of management's responsibility.

42. Pursuant to these requirements, EDS' Annual Reports on Form 10-K for Fiscal 2000 and 2001, filed with the SEC during the Class Period, assured investors that its financial statements:

> present fairly, in all material respects, the financial position of [EDS and subsidiaries for the preceding two years] . . . and the results of their operations and their cash flows for each of the three [preceding] years in the period ended December 31 . . . in conformity with accounting principles generally accepted in the United States of America.

43. EDS also represented in its quarterly reports on Form 10-Q for each of the first three quarters of Fiscal 2001 and the first two quarters of Fiscal 2002 filed with the SEC during the Class Period, that its financial results were presented appropriately, in accordance with GAAP:

> The accompanying unaudited condensed financial statements of [EDS] . . . have been prepared in accordance with [GAAP] for interim financial information. In the opinion of management, all adjustments, which are of a normal recurring nature and necessary for a fair presentation, have been included . . . .

44. Defendants Brown and Daley further represented in sworn certifications filed with the SEC, dated July 25, 2002, that neither EDS' Annual Report on Form 10-K for Fiscal 2001, nor EDS' quarterly reports on Form 10-Q for the first two quarters of Fiscal 2002, "contained an untrue statement of a material fact as of the end of the period covered by such report," or "omitted to state a material fact necessary to make the statements in the covered report, in light of the circumstances under which they were made, not misleading as of the end of the period covered by such report . . . ."

45. Despite these assurances, EDS inflated its revenues and earnings during the Class Period by improperly recognizing revenue on the NMCI Contract by using the percentage of completion method of accounting.

46. Accounting Research Bulletin No. 45 ("ARB No. 45"), Long-Term Construction-Type

Contracts, issued by the AICPA Committee on Accounting Procedure in 1955, describes the two generally accepted methods of accounting for long-term contracts for financial reporting purposes:

- The percentage-of-completion method recognizes income as work on a contract progresses; recognition of revenues and profits generally is related to costs incurred in providing the services required under the contract.

- The completed-contract method recognizes income only when the contract is completed, or substantially so, and all costs and related revenues are reported as deferred items in the balance sheet until that time.

47. ARB No. 45, ¶15, describes the circumstances in which each method is preferable as follows:

> The committee believes that in general when estimates of costs to complete and extent of progress toward completion of long-term contracts are reasonably dependable, the percentage of completion method is preferable. When lack of dependable estimates or inherent hazards cause forecasts to be doubtful, the completed contract method is preferable.

48. AICPA Statement of Position 81-1 ("SOP 81-1"), entitled Accounting for Performance of Construction-Type and Certain Production-Type Contracts, precludes recognizing revenue under the percentage of completion method unless the contractor has the "ability to make reasonably dependable estimates . . . of the extent of progress toward completion, contract revenues, and contract costs." SOP 81-1, ¶23. SOP 81-1 continues by stating: "An entity using the percentage-of-completion method as its basic accounting policy should use the completed-contract method for a single contract or group of contracts for which reasonably dependable estimates cannot be made or for which inherent hazards make estimates doubtful." SOP 81-1, ¶25.

49. Throughout the Class Period, defendants knew that the NMCI Contract suffered from severe problems that should have precluded revenue recognition under SOP 81-1, including the following:

(i) an inability to transfer necessary software applications to new workstations, thereby requiring intranet users to use two computers rather than one to perform their jobs; and (ii) a failure to provide key secure website access for intranet users, thereby further undermining and delaying the transition to the NMCI Intranet. Defendants also knew or, but for their severe recklessness, should have known that these problems had precluded EDS from demonstrating the successful installation of even 5% of the new intranet, as set forth in ¶¶31-35, above.

50. Defendants also knew or, but for their severe recklessness, should have known that EDS lacked the ability to produce reasonably dependable estimates that would allow revenue recognition under the percentage of completion method of accounting. As set forth in SOP 81-1, "the ability to produce reasonably dependable estimates is an essential element of the contracting business . . . an entity without the ability to update and revise estimates continually with a degree of confidence could not meet that essential requirement of GAAP." SOP 81-1, ¶26. SOP 81-1 further provides that "[p]revious reliability of a contractor's estimating process is usually an indication of continuing reliability, particularity if present circumstances are similar to those that prevailed in the past."

51. Defendants knew well that EDS' estimating process was unreliable based on past experiences with other contracts for which EDS recognized revenue under the percentage of completion method of accounting. For example, the Company reported a $200 million adjustment to revenue for the fourth quarter of 1998, as discussed in a February 5, 1999 Bear Stearns analyst report:

> EDS said the $200 million adjustment to revenue is primarily related to a legal dispute with Xerox (a small portion of the $200 million is actually related to another profit challenged contract.) EDS filed suit against Xerox in New York State Court over Xerox's obligation to pay for certain infrastructure services (Xerox is one of EDS' biggest customers). While EDS did not offer a clear explanation on the revenue adjustment, we believe that it relates

> to previously recognized revenue that is now in dispute. Under the percentage of completion accounting, EDS makes a profit assumption for the life of a contract and recognizes revenue accordingly. Based on the dispute and EDS' experience thus far on the Xerox contract, the original profit assumptions made by EDS were way off the mark. Erroneous contract profit assumptions have plagued EDS over the past several years. *EDS has incurred significant "non-recurring" charges over the past three years related to contracts that have performed below expectations and/or have been terminated.* (emphasis added.)

52. One internal auditor who worked for EDS from 1998 until mid-2000 and audited certain EDS operating units in London, San Paulo and Argentina also criticized EDS' use of the percentage of completion method prior to the Class Period. The auditor stated that if EDS had budgeted $500,000 in costs to a contract, once costs reached a certain level, i.e., $250,000, EDS would consider the project 50% completed, regardless of the fact that the project may only have been 10% or 20% complete. Indeed, according to a second internal auditor working on the same internal audit of foreign subdivisions, EDS outside auditor KPMG LLP had sent EDS letters in 1996, 1997 and 1998 stating it was uncomfortable with the Company's accounting practices in EDS' non-US operating units.

53. For example, one of these internal auditors discovered that EDS was improperly recognizing revenue on its contract with Golden Cross, Brazil's largest medical insurance company. EDS won the contract, which was worth $50 to $100 million, in 1997 or 1998 to perform data processing for the servicing of claims. As part of the project, EDS was required to write software to perform data processing. Golden Cross, however, had failed to provide EDS with sufficient information to complete the software and EDS could not complete the project. In January 1999, however, this internal auditor discovered that EDS was recognizing revenue under the contract despite its inability to write the necessary software. This auditor spent a day reviewing the contract with Scott Lundering, EDS' Vice President of

Legal Affairs. When informed of the violation, Doreen Clements, EDS' Vice President of Worldwide Shared Services and John Adams, EDS' controller, indicated their awareness of the problem.

54. Knowing the Company's past unreliability in its ability to produce reasonably dependable estimates of costs to complete and the extent of progress toward completion of long-term contracts, defendants knew or were severely reckless in disregarding that similar deficiencies existed in its ability to estimate revenues and costs with respect to the NMCI Contract. In May 2003, EDS revealed that it had discovered "deficiencies in the operational effectiveness of controls over the process for estimating revenues and costs for the remaining term of the NMCI Contract," and that these deficiencies rose to the level of a "reportable condition." Generally Accepted Auditing Standards ("GAAS"), and specifically AU § 325, ¶2, define a reportable condition as:

> significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

55. Although EDS did not specify the precise material deficiencies present in its internal controls, it disclosed the following remedial measures being taken: increasing the frequency and scope of operational and financial reviews with senior account personnel; staffing its program management office with new staff; adhering to the process for approval of change orders more strictly; reorganizing EDS' account support functions and appointing a senior service delivery executive; assigning additional finance and legal staff to the NMCI account; improving the Company's monitoring and reporting seat deployment; and improving communication with senior client representatives. Defendants' knowledge of these deficiencies during the Class Period, or their severe recklessness in not knowing that these deficiencies existed, combined with the other departures from GAAP set forth above, precluded recognizing revenue under the

NMCI Contract using the percentage of completion method of accounting.

56. Further, ¶24 of SOP 81-1 provides that, "[f]or a contract on which a loss is anticipated, GAAP requires recognition of the entire anticipated loss as soon as the loss becomes evident." EDS violated GAAP by not recording a provision for losses on the NMCI Contract in a timely manner. Provisions for losses must be made in the period in which they become known under either the percentage of completion method or completed contract method. SOP 81-1, ¶85. Defendants either knew, or were severely reckless in disregarding that EDS had incurred over $300 million in losses on the NMCI Contract during the Class Period, which EDS concealed from the public in violation of GAAP, due to the severe implementation problems set forth in ¶¶31-35, above.

DEFENDANTS' FALSE AND MISLEADING
STATEMENTS DISSEMINATED DURING THE CLASS PERIOD

Q4 2000

57. On February 7, 2001, the first day of the Class Period, defendants issued a press release reporting revenue of $5.2 billion and $19.2 billion for the fourth quarter and year end of Fiscal 2000, compared to $4.92 billion and $18.73 billion for the comparable periods in 1999. EDS' revenues for 2000 included approximately $10 million from the NMCI Contract. EDS further reported earnings per share ("EPS") for the quarter of 70 cents, excluding one-time items, marking the seventh consecutive quarter of comparable year over year double-digit EPS growth. In listing its fourth quarter 2000 milestones, EDS reported it was the "[h]ighest quarter for revenue" and earnings per share. The Company reported net income for the year of $321.4 million.

58. On March 16, 2001, EDS filed with the SEC its consolidated Annual Report on the Form

10-K for the year ended December 31, 2000 ("2000 Form 10-K"), which confirmed the Company's financial results for the fourth quarter and Fiscal 2000 results as initially reported in the Company's earnings release dated February 7, 2001. EDS further reported in the 2000 Form 10-K that "[t]otal revenues increased 3% to $19.2 billion, up from $18.7 billion in 1999 . . . . Base revenues [revenues from clients other than General Motors and its affiliates] grew 5% in 2000 to $15.9 billion . . . ." Also, EDS assured investors in its 2000 Form 10-K that "[p]rovisions for estimated losses are made in the period in which the loss first become apparent." Finally, the 2000 Form 10-K assured investors that its financial statements:

> present fairly, in all material respects, the financial position of [EDS and subsidiaries for the preceding two years] . . . and the results of their operations and their cash flows for each of the three [preceding] years in the period ended December 31 . . . in conformity with accounting principles generally accepted in the United States of America.

The 2000 Form 10-K was signed by defendants Brown and Daley.

59. Each of the statements identified in ¶¶57-58 were materially false or misleading when made because defendants knew or were severely reckless in disregarding that EDS had significant deficiencies in the operational effectiveness of its internal controls to estimate revenues and costs for the NMCI Contract. Specifically, in the first quarter of 2003, EDS would be forced to reveal that it had discovered "significant" deficiencies which its auditors had determined to be a reportable condition with respect to EDS' operational effectiveness of its controls over the process for estimating revenues and costs for the NMCI Contract. The existence of these significant deficiencies meant that the Company should not have recognized revenue on the NMCI Contract using the percentage of completion method of accounting, but should have waited until work was completed on this contract to recognize revenue, as set forth in ¶¶41-55, above.

60. Following the release of the Company's false and misleading financial results, analysts commented positively on the Company's fourth quarter results which were based on and repeated the false financial information provided by EDS' management. In particular, in his report dated February 8, 2001, Karl Keirstead ("Keirstead") of Lehman Brothers reported: "[a]fter 5 consecutive quarters of declining and weak revenue growth, EDS finally delivered a stellar top-line performance, with 4Q00 revenues of $5.2 billion, up 6% overall and above our $5.0 billion estimate . . . ." Upon news of EDS' fourth quarter and year end 2000 financial results, the value of the Company's stock rose from a closing price of $56.90 per share on February 7, 2001, to $61.25 per share in after-hours trading on that day, and to a closing price of $62.51 per share on February 8, 2001, an increase of approximately 10%. By February 13, 2001, the value of EDS common stock had increased 13%, reaching $64.16 per share.

Q1 2001

61. On April 25, 2001, after the market closed, EDS issued a press release reporting total first quarter 2001 revenue of $5.0 billion, compared to $4.57 billion for the quarter ended March 31, 2000. The Company further reported earnings per share of 56 cents, noting it marked the eighth consecutive quarter of double-digit EPS growth. EDS also reported net income of $446.1 million. In the press release, Brown stated: "EDS' momentum continues in 2001, buoyed by accelerating revenue growth . . . Despite a challenging world economy, EDS' performance was strong in the quarter. This is supported by our record contract signings, double-digit base revenue and earnings growth, and improved margins."

62. On April 25, 2001, defendants held a conference call to discuss its earnings for the first quarter of 2001. Brown and Daley hosted the call, in which they reiterated EDS' financial results for the first quarter of 2001 as reported in the April 25, 2001 earnings release. Daley also reported that for the

first quarter, base revenue from the Information Solutions segment was up 20% on a constant currency and organic basis. In response to questioning from David Togut from Morgan Stanley concerning the drivers behind this growth, Daley attributed up to 1% of the increase to the Navy contract.

63. On or about May 15, 2001, EDS filed with the SEC its Form 10-Q for the period ending March 31, 2001 ("Q1 2001 10-Q"), which confirmed the false and misleading results discussed in the Company's April 25, 2001 earnings release and conference call. In addition, the Q1 2001 10-Q also reported revenues for the Information Solutions unit of $3.68 billion. The Q1 2001 10-Q further represented that these financial results were presented in accordance with GAAP and that "[i]n the opinion of management, all adjustments, which are of a normal recurring nature and necessary for a fair presentation, have been included." Both Brown and Daley approved of the statements contained in the Q1 2001 10-Q, and Daley signed it.

64. Each of the statements identified in ¶¶61-63 were materially false and misleading when made because defendants knew or were severely reckless in disregarding that:

(a) As EDS' independent auditors would later confirm significant deficiencies existed in the operational effectiveness of the Company's internal controls over the process of estimating its revenues and costs with respect to the NMCI Contract. Thus, as described in ¶¶41-55, above, EDS lacked the ability to make reasonably dependable estimates which should have precluded it from recording revenue using the percentage of completion method of accounting for the NMCI Contract; and

(b) In using the percentage of completion method of accounting, EDS improperly recognized revenue from the NMCI Contract in the first quarter of 2001 because, as detailed in ¶31, defendants knew that EDS was delivering defective products, which along with the problems associated with the unsuccessful transfer of thousands of legacy software applications, were causing delays and costs overruns that caused EDS to incur substantial losses on the NMCI Contract during the Class Period.

65. Analysts again reacted positively to the Company's first quarter 2001 results. In particular, Keirstead of Lehman Brothers rated EDS stock a "buy." In his report dated April 26, 2001, Keirstead noted that the first quarter of fiscal 2001 marked the "2nd straight quarter of revenue upside"

66. Similarly, in a report dated April 26, 2001, Goldman Sachs emphasized EDS' stellar revenue growth, stating: "FOR YEARS, EDS' WEAK POINT HAS BEEN TOP LINE PERFORMANCE, AND Q1/O1 WAS THE SECOND CONSECUTIVE QUARTER OF BETTER THAN EXPECTED GROWTH, AND WELL ABOVE HISTORICAL LEVELS. THIS IS THE EVIDENCE THAT LAST YEAR'S RECORD CONTRACT WINS ARE NOW TRANSLATING INTO REVENUE." Days later, in a report dated April 30, 2001, Goldman Sachs deemed EDS' results to be "evidence of EDS' successful transition back to a true, top-line driven growth company."

Q2 2001

67. On July 25, 2001, after the market closed, EDS issued a press release reporting revenues of $5.09 billion compared to $4.65 billion for the comparable period in Fiscal 2000. Of that amount, EDS stated base revenues totaled $4.31 billion for the three months ended June 30, 2001. EDS further reported that earnings per share increased 17% to 62 cents from 53 cents in the year ago quarter, marking the ninth consecutive quarter of double-digit EPS growth. The Company further reported that net income rose 18% to $300 million, compared with $254 million a year ago.

68. On August 8, 2001, EDS filed with the SEC its Form 10-Q for the period ending June 30, 2001 ("Q2 2001 10-Q"), which confirmed the results announced in the Company's July 25, 2001 earnings

release. The Q2 2001 10-Q further represented that these financial results were presented in accordance with GAAP and that "[i]n the opinion of management, all adjustments, which are of a normal recurring nature and necessary for a fair presentation, have been included." Both Brown and Daley approved the statements contained in the Q2 2001 10-Q, and Daley signed it.

69. Each of the statements identified in ¶¶67-68 were materially false and misleading when made because defendants knew or were severely reckless in disregarding that:

(a) As EDS' independent auditors would later confirm significant deficiencies existed in the operational effectiveness of the Company's internal controls over the process of estimating its revenues and costs with respect to the NMCI Contract. Thus, as described in ¶¶41-55, EDS lacked the ability to make reasonably dependable estimates which should have precluded it from recording revenue using the percentage of completion method of accounting for the NMCI Contract; and

(b) In using the percentage of completion method of accounting, EDS was improperly recognizing revenue from the NMCI Contract in the second quarter of 2001 because, as detailed in ¶31, defendants knew that EDS was delivering defective products, which along with the problems associated with the unsuccessful transfer of thousands of legacy software applications, were causing delays and costs overruns that caused EDS to incur substantial losses on the NMCI Contract during the Class Period.

<u>Q3 2001</u>

70. On October 24, 2001, after the market closed, EDS issued a press release reporting revenues of $5.6 billion, compared to $4.79 billion a year ago, and, excluding a one-time acquisition item, earnings per share of 69 cents, a 17% increase above the 59 cents reported in the year ago quarter. The Company reported base revenues of $4.8 billion. In listing its third quarter "milestones," EDS noted it was

the tenth consecutive quarter of double-digit year-over-year EPS growth. The Company further reported that "[w]ith a 21 percent revenue increase, Information Solutions, EDS' strategic infrastructure business, achieved its third consecutive quarter of 20 percent or better organic growth."

71. On October 24, 2001, EDS held a conference call to discuss its earnings for the third quarter of 2001. Brown and Daley hosted the call, in which they reiterated EDS' financial results for the third quarter of 2001 as contained in the October 24, 2001 earnings release. Daley further stated that "[t]hird quarter revenue growth in Information Solutions was also favorably impacted by the NMCI Contract. Progress on this contract is ahead of plan and current year contract revenues are greater than we had initially anticipated."

72. During the October 24, 2001 conference call, Brown also stated: "We have booked $230 million in revenues from the Navy in the third quarter and in 2001, an incremental increase of about 2% has been the impact on our revenues, total EDS revenues."

73. On November 13, 2001, EDS filed with the SEC its Form 10-Q for the period ending September 30, 2001 ("Q3 2001 10-Q"), which confirmed the financial results announced in the Company's October 24, 2001 earnings release. For the quarter, the Q3 2001 10-Q also represented that revenues from the Information Solutions segment accounted for $4.2 billion. The Q3 2001 10-Q further represented that these financial results were presented in accordance with GAAP and that "[i]n the opinion of management, all adjustments, which are of a normal recurring nature and necessary for a fair presentation, have been included." Both Brown and Daley approved the statements contained in the Q3 2001 10-Q, and Daley signed it.

74. Each of the statements identified in ¶¶70-73 were materially false and misleading when

made because defendants knew or were severely reckless in disregarding that:

(a) As EDS' independent auditors would later confirm significant deficiencies existed in the operational effectiveness of the Company's internal controls over the process of estimating its revenues and costs with respect to the NMCI Contract. Thus, as described in ¶¶41-55, EDS lacked the ability to make reasonably dependable estimates which should have precluded it from recording revenue using the percentage of completion method of accounting for the NMCI Contract; and

(b) In using the percentage of completion method of accounting, EDS improperly recognized revenue from the NMCI Contract in the third quarter of 2001 because, as detailed in ¶¶31-32, defendants knew that EDS was delivering defective products, which along with the problems associated with the unsuccessful transfer of thousands of legacy software applications, were causing delays and costs overruns that was causing EDS to incur substantial losses on the NMCI Contract during the Class Period.

75. In reporting on EDS' financial results for the third quarter of 2001, investment analysts reacted favorably to the Company's announcements. On October 24, 2001, *Bloomberg* reported on EDS' third quarter 2001 results noting that, despite the decline in General Motors revenue, EDS' largest customer, the Company has met or beaten forecasts in the past year with an "annuity-like stream of revenue from multi year contracts to run computer systems."

76. Other analysts specifically commented on the NMCI Contract and its beneficial impact on EDS' financial results. On October 25, 2001, Keirstead of Lehman Brothers rated EDS a "buy" noting in his report that "EDS recorded a strong and unexpected 3Q01 revenue performance . . . The Navy deal alone added $230 million in revenues or about 6% to the non-GM growth."

77. In a report dated October 25, 2001, institutional analyst Friedman, Billings, Ramsey & Co.

("FBR") echoed Keirstead's positive review and rated EDS shares "accumulate." In the report, FBR observed that "[t]he revenue result of $5.5 billion was driven by strong performance across all company's lines of business." Specifically, FBR noted that "[o]n a year over year organic basis, [Information Solutions] grew 21% driven by strong performance with the NMCI Contract . . . ."

Q4 and Year-End 2001

78. On February 7, 2002, after the market closed, EDS issued a press release announcing that it achieved "record" total revenue of $5.9 billion for the fourth quarter and $21.5 billion for 2001, compared to $5.2 billion and $19.2 billion for the fourth quarter and year 2001. Of that amount, revenues from base (non-GM) clients were $5.15 billion for the fourth quarter and $18.47 billion for the year. EDS reported net income of $405 million and $1.36 billion for the fourth quarter and fiscal year 2001, respectively. Defendants further reported earnings per share for the fourth quarter of 2001, excluding a one time credit, of 81 cents – a 16% increase over the comparable result of 70 cents for the prior year. For all of 2001, EDS reported earnings per share, before one time items, of $2.68, a 17% increase from the comparable result of $2.29 in 2000. In listing "milestones" for the quarter, EDS noted it was the eleventh consecutive quarter of comparable year-over-year, double-digit earnings per share growth. In the press release, Brown stated: "'EDS has stayed the course of steady, consistent, profitable growth . . . Our unwavering commitment to service excellence produced record revenues . . . .'"

79. On February 7, 2002, EDS held a conference call to discuss its earnings for the fourth quarter and fiscal year 2001. Brown and Daley hosted the call, in which they reiterated EDS' revenue and earnings per share results. Brown also provided assurance that "EDS's financial foundation is rock solid. Our accounting is conservative, clear, concise."

80. On March 6, 2002, EDS filed with the SEC its Annual Report on Form 10-K for the year ended December 31, 2001 ("2001 Form 10-K"), which confirmed EDS' fourth quarter and fiscal year 2001 results that were initially reported in the Company's February 7, 2002 earnings release. The 2001 Form 10-K also reported that included in its revenues were unbilled revenues of $1.84 billion and $1.03 billion at December 31, 2001 and December 31, 2000, respectively, representing costs and related profits in excess of billings on certain unit-price and fixed-price contracts. EDS further assured investors in its 2001 Form 10-K that "[p]rovisions for estimated losses are made in the period in which the loss first become apparent." EDS also represented that its financial statements:

> present fairly, in all material respects, the financial position of [EDS and subsidiaries for the preceding two years] . . . and the results of their operations and their cash flows for each of the three [preceding] years in the period ended December 31 . . . in conformity with accounting principles generally accepted in the United States of America.

Both Brown and Daley signed the 2001 Form 10-K.

81. Each of the statements identified in ¶¶78-80 were materially false and misleading when made because defendants knew or were severely reckless in disregarding that:

(a) As EDS' independent auditors would later confirm, significant deficiencies existed in the operational effectiveness of the Company's internal controls over the process of estimating its revenues and costs with respect to the NMCI Contract. Thus, as described in ¶¶41-55, EDS lacked the ability to make reasonably dependable estimates which should have precluded it from recording revenue using the percentage of completion method of accounting for the NMCI Contract; and

(b) In using the percentage of completion method of accounting, EDS improperly recognized revenue from the NMCI Contract in the fourth quarter of 2001 because, as detailed in ¶¶31-32, defendants knew that EDS was delivering defective products, which along with the problems associated with the unsuccessful transfer of thousands of legacy software applications, were causing delays and costs overruns that was causing EDS to incur substantial losses on the NMCI Contract during the Class Period.

82. Upon the filing of the Company's 2001 Form 10-K, the value of EDS stock rose from a closing price of $63.63 per share on March 6, 2002 to a closing price of $64.09 per share on March 8, 2002. In a February 8, 2002 report, Salomon Smith Barney rated EDS stock a "buy," while noting the increase in unbilled revenue due to the signing of the NMCI Contract:

> [W]e note that EDS' unbilled receivables have increased from $1.03 billion in 2000 to about $1.8 billion in 2001. This is a steep increase when compared to the relatively modest increase in this value from 1999 to 2000. Unbilled receivables are a function of the difference between a linear time and material based on work schedule and a periodic, contractual milestone-based payment schedule. We note that nearly a third of the 2001 unbilled receivables are from various governments (primarily the US government for the NMCI Contract.).

<u>Q1 2002</u>

83. On April 22, 2002, after the market closed, EDS issued a press release reporting total revenue for the quarter was $5.34 billion, compared with $4.98 billion in 2001, and earnings per share of 72 cents versus the comparable result of 63 cents a year ago. Revenues from non GM clients accounted for $4.65 billion of total revenues. The press release touted EDS' increase in earnings per share, noting it marked the Company's twelfth consecutive quarter of double-digit EPS growth. EDS also reported that net income was $354 million, up 18% from $301 million in the 2001 period.

84. On April 22, 2002, EDS held a conference call to discuss its financial results for the first quarter of 2002. During the call, Brown admitted that the majority of the Company's unbilled revenue resided in contracts like the NMCI Contract. Daley also remarked that the Company's unbilled revenues

increased $1 billion at the end of the first quarter of 2000 to $2.2 billion at the end of the year first quarter 2001.

85. On May 6, 2002, EDS filed with the SEC its Form 10-Q for the period ending March 31, 2002 ("Q1 2002 10-Q"). The Q1 2002 10-Q contained the quarterly financial statements for EDS for the first quarter of Fiscal 2002, which confirmed the results announced in the Company's April 22, 2002 earnings release. The Q1 2002 10-Q further represented that these financial results were presented in accordance with GAAP and that "[i]n the opinion of management, all adjustments, which are of a normal recurring nature and necessary for a fair presentation, have been included." The Q1 2002 10-Q also reported unbilled revenue of $2.184 billion and $1.84 billion at March 31, 2002 and December 31, 2001, respectively. Both Brown and Daley approved the statements contained in the Q1 2002 10-Q, and Daley signed it.

86. Each of the statements identified in ¶¶83-85 were materially false and misleading when made because defendants knew or were severely reckless in disregarding that:

(a) As EDS' independent auditors would later confirm, significant deficiencies existed in the operational effectiveness of the Company's internal controls over the process of estimating its revenues and costs with respect to the NMCI Contract. Thus, as described in ¶¶41-55, EDS lacked the ability to make reasonably dependable estimates which should have precluded it from recording revenue using the percentage of completion method of accounting for the NMCI Contract; and

(b) In using the percentage of completion method of accounting, EDS improperly recognized revenue on the NMCI Contract in the first quarter of 2002 because, as detailed in ¶¶31-35, defendants knew that EDS was delivering defective products, which along with the problems associated with the unsuccessful transfer of thousands of legacy software applications, were causing delays and costs overruns. Further, by September 2001, as detailed in ¶32, the Navy had deferred orders under the NMCI Contract due to the various problems encountered in the implementation of the NMCI Contract, which further delayed and increased costs associated with the NMCI Contract. Moreover, in April 2002, as detailed in ¶37, to circumvent the problems slowing down EDS' implementation of the NMCI Contract and its ability to recognize revenue, EDS embarked on a "scorched earth policy" designed to deliver equipment to the Navy virtually regardless of its functionality, or even an order from the Navy, and recognized revenue on these deliveries in violation of GAAP.

87. The news of the Company's results for the first quarter of 2002 caused the value of EDS stock to rise from a closing price of $51.30 per share on April 22, 2002 to a closing price of $52.80 per share on April 23, 2002. As in the past, analysts reported favorably on EDS' results. On April 23, 2002, Chris Penny, an analyst for FBR, maintained his "buy" rating on the stock, while also noting that "[u]nbilled revenue more than doubled in 1Q01 (sic) to $2.184 billion from $1.087 in 1Q00. The majority of the increase is due to the investment requirements for the NMCI Contract and for the UK's Inland Revenue Service."

<u>Q2 2002</u>

88. On June 30, 2002 and July 1, 2002, the *New York Times* and the *Wall Street Journal*, respectively, published articles critical of EDS' accounting practices. The *New York Times* raised questions over the manner in which EDS was accounting for its cash flow. The *Wall Street Journal* questioned a number of the Company's accounting practices, including the manner in which EDS used the percentage of completion method of accounting to account for "unbilled revenue," and criticized EDS' use

of zero profit on large deals in early stages, simply matching expenses with revenues. The *Wall Street Journal* article further noted that as of March 31, 2002, the Company's unbilled revenue had doubled from the same period a year earlier to $2.18 billion, largely due to the NMCI Contract. According to the article, "Scot McDonald, the company's chief accounting officer, concedes EDS would have to write off any of its $2.18 billion in unbilled revenue if it failed to materialize."

89. On July 1, 2002, Keirstead of Lehman Brothers also raised troubling questions concerning the Company's accounting practices. Keirstead's report highlighted how dependent investors were on the integrity of defendants to properly recognize revenue on its long term contracts, like the NMCI Contract:

> The second major Street issue relates to cash flow generation. Despite accelerating revenue growth and solid earnings, free cash flow was just $178 million in 2002 . . . . The bearish voices attribute this to poor profitability on recent contracts and/or aggressive accounting practices . . . .
>
> Needless to say, it is impossible to know the "real" profitability and cash flow characteristics of particular multi-billion dollar 10-year outsourcing arrangements. In fact, this inherent uncertainty . . . is a material reason why EDS shares have under-performed in this new environment of accounting related suspicion. The balance sheet "facts" are not encouraging, but the EDS explanation seems reasonable. What to believe? . . . Ultimately, however, it comes down to a question of trust. In our view, the current EDS management has performed relatively well since being assembled in early 1999; Dick Brown and his team turned around a troubled organization . . . we believe in the integrity of the EDS management team and that the CFO and his reports are not playing accounting games to boost reported earnings.

Keirstead therefore rated EDS a "strong buy."

90. Defendants continued to defend EDS' accounting practices in the face of these questions. On July 2, 2002, in the wake of WorldCom's revelation concerning its own improper accounting, EDS held an analysts' teleconference to discuss the Company's relationship with WorldCom and EDS' own financial policies and practices. Brown and Daley hosted the call. According to Brown, the purpose of the call was

to put a "stake in the ground" and make clear that the Company's accounting is "*clear, conservative and concise*." Further, despite the fact that Brown knew or, but for his severe recklessness, should have known of the significant deficiencies existing in EDS' controls with respect to the NMCI Contract, Brown stated that "*EDS is a company with strong financial controls and the discipline to follow them*." (emphasis added.) In discussing the Company's use of the percentage of completion accounting method, Daley claimed that "*EDS's system around estimating costs is extremely sophisticated. And actually, I find it very robust from a risk assessment point of view*." (emphasis added.)

91. During the call, Brown reiterated Daley's claim that EDS had strong internal controls: "*As Jim pointed out, I can tell you that we have strong internal controls in place to make sure that margin adjustments [on profit of a contract] are only made when milestones are complete*." (emphasis added.) At the end of the call, Brown emphasized that EDS "*put a lot of controls and processes that absolutely minimize [EDS] risk* . . . ." (emphasis added.)

92. On July 24, 2002, defendants issued a press release announcing that, for the second quarter of 2002, EDS' total revenue increased 8% to $5.5 billion versus $5.1 billion for the same quarter one year earlier. Of that amount, base revenues totaled $4.81 billion. Defendants further reported earnings per share of 64 cents and net income of $316 million. Excluding the impact of a provision for WorldCom's bankruptcy, EDS reported that second quarter 2002 earnings per share and net income would have been 78 cents a share and $383 million. In the press release, Brown stated: "*EDS' business and financial fundamentals are sound* . . . We continued to gain market share and increase revenue despite the continued weak corporate spending environment and the impact of WorldCom." (emphasis added.)

93. On July 24, 2002, EDS held a conference call to discuss EDS' second quarter of 2002.

Both Brown and Daley hosted the call and reaffirmed the Company's results for the second quarter of 2002 as first reported in EDS' July 24, 2002 earnings release. During the call, Daley stated that "EDS' accounting policies and procedures are conservative, consistent, clear and complete. We say this, too, with confidence and without hesitation." With respect to the increase in unbilled revenue, Daley stated that $300 million of the $392 million increase in unbilled revenue resulted from EDS' government business. In providing further detail, Daley also stated that "well over 50% of the total $2.6 billion of unbilled revenue balance is associated with government contracts and all of the increase in government contracting activity is associated with the Navy contract and the work we're doing for an agency in the – of the U.K. government."

94. On the call, Daley expressed comfort with consensus analyst estimates for the third quarter and the fiscal year 2002:

> [W]e are . . . comfortable with the first call consensus for the third quarter after it is reduced to 74 to 75 cents per share to take into account the additional 5 cents per share of pre-bankruptcy reserves. . . . We are also comfortable with the first call consensus for the full year 2002. Again, once the impact of the Worldcom provisions in the 2nd and 3rd quarters, that is in the range of 22 to 23 cents per share are reflected in the consensus. This will bring the new consensus number for the full year 2002 to about $3 even.

95. On July 26, 2002, EDS filed with the SEC its Quarterly Report on the Form 10-Q for the period ended June 30, 2002 ("Q2 2002 10-Q"), which confirmed the results announced in the Company's July 24, 2002 earnings release. The Q2 2002 10-Q further represented that these financial results were presented in accordance with GAAP and that "[i]n the opinion of management, all adjustments, which are of a normal recurring nature and necessary for a fair presentation, have been included." In conjunction with this filing, Daley and Brown each filed a sworn certification with the SEC, as required by SEC Order No.

4-460, attesting to the accuracy of EDS' reported financial results for Fiscal 2001, and for the first two quarters of Fiscal 2002. Defendant Daley signed the Q2 2002 10-Q.

96. In the Q2 2002 10-Q, the Company further reported unbilled revenue of $2.57 billion at June 30, 2002 and $1.85 billion at December 31, 2001. The Q2 2002 10-Q attributed the unbilled revenue increase of $731 million to $2.6 billion at June 30, 2002 from $1.8 billion at December 31, 2001 to investments in significant contracts signed by the Company during 2001 and late 2000 with U.S. and U.K. government clients and foreign currency translation adjustments. "Approximately 55% of unbilled revenue at June 30, 2002 related to contracts with governments . . . ."

97. Each of the statements identified in ¶¶90-96 were materially false and misleading when made because defendants knew or were severely reckless in disregarding that:

(a) As EDS' independent auditors would later confirm, significant deficiencies existed in the operational effectiveness of the Company's internal controls over the process of estimating its revenues and costs with respect to the NMCI Contract. Thus, as described in ¶¶41-55, EDS lacked the ability to make reasonably dependable estimates which should have precluded it from recording revenue using the percentage of completion method of accounting for the NMCI Contract; and

(b) In using the percentage of completion method of accounting, EDS improperly recognized revenue from the NMCI Contract in the second quarter of 2002 because, as detailed in ¶¶31-35, defendants knew that EDS was delivering defective products, which along with the problems associated with the unsuccessful transfer of thousands of legacy software applications, were causing delays and costs overruns. Further, by September 2001, as detailed in ¶32, the Navy had deferred orders due to various problems encountered in the implementation of the NMCI Contract, which further delayed and increased costs associated with the contract. Moreover, in April 2002, as detailed in ¶37, to circumvent the problems slowing down EDS' implementation of the NMCI Contract and its ability to recognize revenue, EDS embarked on a "scorched earth policy" designed to deliver equipment to the Navy virtually regardless of its functionality, or even an order from the Navy, and recognized revenue on the deliveries, in violation of GAAP.

98. Investment analysts were satisfied with EDS' reported results, including the Company's accounting for unbilled revenue. For example, on July 25, 2002, Salomon Smith Barney reported as follows:

> With regards to details on the unbilled receivables, we note the following. Over $300 million of the increase is related to the Navy. As, discussed in prior notes, much of the increase in unbilled receivables over the past 18 months has been due to the Navy contract (60%) and the UK Social Services contract (15-20%). We do not view either as a credit risk, and the increases are related to milestones that EDS hopes to cross later this year (for UK DSS) and the Navy contract (early next year). When the contracts transition from a milestone basis to a transaction-basis, the unbilled receivables issue should start sorting itself out.

99. In August 2002, just weeks before the end of the Class Period, defendants reiterated their earnings guidance for the third quarter as set forth in ¶94, above. On August 23, 2002, Gary Helmig of SoundView Tech. reported, based upon a meeting with Brown and Daley that month, that "EDS' management is very positive in its outlook and on the Company's ability to continue to meet expectations." Further, according to a Bear Sterns report dated, September 19, 2002, EDS management represented in late August the quarter was on track.

DISCLOSURE OF THE FRAUD

100. On September 18, 2002, approximately one month after defendants assured analysts that

the company would meet prevailing revenue and earnings expectations, EDS issued a press release warning that its revenue and earnings for the third quarter of 2002 would be much lower than previous company guidance. According to its September 18 press release, EDS reported that it expected total revenue of $5.3-$5.5 billion, down 2-5% from the $5.6 billion reported a year ago, and well below the 4-6% increase previously projected by the Company. EDS also reported that it expected to report earnings per share of $0.12-$0.15 cents for the quarter as opposed to the $0.74 per share it had estimated one month earlier - approximately $0.62 - $0.64 below consensus estimates. While the Company failed to provide much detail in its press release concerning this huge miss, it did attribute part of the lower estimate to the "financial performance of certain contracts primarily in Europe."

101. Although EDS did not specifically identify the NMCI Contract as a contributor to its shortfall, investment analysts questioned EDS' use of the percentage of completion method to recognize revenue on long term contracts, speculating that management had not told the full story. For example, on September 19, 2002, Bear Stearns stated:

> We feel that there is a lot more to EDS' revised guidance than the factors cited by management. To the extent that EDS mispriced contracts over the past several years and then accounted for them under POC, we may be in for a prolonged period of depressed earnings at EDS.

102. Similarly, FBR downgraded EDS to "underperform" and questioned management's credibility and explanation for the miss in its report:

> While management points out that the current economic environment is a large factor in the third quarter performance, we believe the majority of the issues facing EDS are very company-specific. Undoubtedly, the spending environment is tough, but it has been tough for a long time and for it to sneak up on EDS this way makes us question how well-controlled the operations really are.

103. Also, on September 26, 2002, the *Wall Street Journal* reported on EDS' third quarter earnings warning, noting that "it is clear that at least part of the decline will come from its use of an accounting practice that relies on management discretion." The article reported that EDS now expects to earn between $58 million and $74 million for the third quarter, down from its previous estimate of about $364 million and that "[m]ore than 10% of that difference, about $31 million, will come from writing off revenue EDS booked for previous quarters from two European contracts even though it hadn't yet billed for the work."

104. As a result of the Company's announcement, the value of EDS shares plummeted from a closing price of $36.46 per share on September 18, 2002 to a closing price of $17.20 per share on September 19, 2002, a decrease of $19.26 or approximately 52%. The investment community's reaction to the Company's surprising write-offs and lower guidance was severe, not only because of the size of the write-off and its unexpectedness, but also because suspicions were raised that the Company had improperly recognized revenue on other long term contracts.

105. On September 24, 2002, in response to an investment community downgrade, EDS issued a press release to reassure the investment community that the Company's financial position remains strong. EDS also emphasized that lower third quarter guidance "reflects provisions for all known contract issues."

106. On October 1, 2002, EDS announced that the SEC had begun an informal inquiry into the events leading up to its negative earnings announcement. Shortly thereafter, in a conference call with investment analysts on October 30, defendant Daley acknowledged problems with the NMCI Contract, stating that due to "seat deployment signing, and average seat pricing, the [NMCI] contract would remain on zero profit for the foreseeable future." Nonetheless, Daley indicated that defendants expected unbilled

revenue with respect to the Navy account to increase gradually by about $200 million through 2003 and turn cash positive on a monthly basis by the end of 2003.

107. On November 14, 2002, EDS filed with the SEC its quarterly report on the Form 10-Q for the period ended September 30, 2002 ("Q3 2002 10-Q"). The Q3 2002 10-Q provided further detail with respect to the problems underlying the NMCI Contract, including the limited progress made toward completion, as set forth below:

> We developed the pricing for the NMCI Contract based on the assumption that we would receive revenues and seat orders in the amounts and during the periods projected in the contract's pricing schedule. For a number of reasons, including the significant increase in the number of legacy systems we have been required to test and certify during the performance of the contract and the imposition by the Navy and Congress of additional testing requirements beyond the commercial testing requirements anticipated at the time the contract was awarded, the roll-out schedule on which we based our pricing has been delayed significantly.
>
> In October 2002, we executed a modification to the NMCI Contract with the Navy. Under that modification, the base period was extended from five to seven years, with a minimum aggregate purchase obligation of the Navy for certain specified services, primarily "seat services," of $6 billion over the seven year base period. In addition, we released the Navy from any liability under the contract for equitable adjustments or claims attributable to delays in issuing orders for seats up to the date of the modification.
>
> Due to the continuing risk associated with the timing and type of seat deployment, we intend to account for the NMCI Contract on a zero profit basis for the foreseeable future. As of September 30, 2002, our unaudited condensed consolidated balance sheet contained approximately $1.7 billion of assets, consisting of unbilled revenue, property and equipment, and other assets, attributable to the contract. At September 30, 2002, the Navy was authorized to order 160,000 computer seats for the current program year ending September 30, 2003. At such date, we had assumed responsibility for approximately 94,000 seats, of which approximately 86,000 were computer seats. Approximately 30,000 of these computer seats had been switched over to the new environment.

108. Shortly thereafter, on January 7, 2003, EDS announced that it had appointed Robert Swan

as the new CFO, replacing Daley, who was reassigned to the position of Executive Vice President of Client Solutions Global Sales and Marketing. Ten days after Daley's reassignment, EDS disclosed that the SEC had upgraded its informal inquiry to a Formal Investigation.

109. In the weeks that followed, EDS gradually revealed additional shortfalls associated with its long-term contracts, for which it had recognized revenue under the percentage of completion method of accounting. On February 6, 2003, EDS announced that fourth quarter total revenue decreased 5% to $5.5 billion versus $5.8 billion in the year ago period. In a conference call with investment analysts the same day, defendant Brown admitted that EDS had identified additional contracts in the fourth quarter that the Company had recognized using percentage of completion accounting contributed to declining revenues and earnings. When further questioned about the rising level of additional "problem" contracts, defendants claimed that it had to do with "the way we have cost at work and the way we're implementing against that cost profile that had some terms and conditions that needed to be tightened down. . . ." Nonetheless, Brown provided assurance that "it's not our financial accounting systems or our accounting systems. . . ."

110. On March 20, 2003, EDS announced that defendant Brown's employment with the Company had been terminated, "effective immediately." Thereafter, on May 7, 2003, EDS' new management announced that the Company would report a net loss of $126 million or 26 cents per share, compared with earnings per share of 72 cents a year ago, <u>which included a $334 million cumulative loss on the NMCI Contract</u>. In the press release, EDS' new CEO, Michael H. Jordan, stated that "[t]he new management team took extra time this quarter to thoroughly review our business financials. The review led to today's action on the NMCI contract . . . ."

111. As reported in the *TheStreet.com* on May 7, 2003, "losses from the Navy contract – now

expected to be a cash drain until the middle of next year – pushed [EDS] to an overall quarterly loss of $126 million or $0.26 a share."

112. On May 8, 2003, Merrill Lynch issued a comment on EDS' third quarter 2002 earnings and discussed EDS' management's acknowledgment that the NMCI Contract will generate operating losses over its total life:

> After writing off $334 mil. in 1Q to "true up" lifetime margin expectations and pushing out cash flow breakeven from Q4'03 to mid '04, the remaining $1.9 bil. in expected lifetime cash flows will merely offset EDS' existing assets and remaining implementation costs. This equates to break-even on the remaining contract from an accounting perspective, but a money-losing contract on a net present value basis. . . Finally, the management conceded to oversight issues at the Navy contract which will require increased project management and financial resources . . . We are concerned by the revelation: NMCI has been perhaps the most visible contract in EDS' portfolio, and should already have received an unusual level of management scrutiny. This disclosure raises concerns about project forecasting and project management capabilities at less visible projects.

113. EDS' new management also finally acknowledged the existence of significant deficiencies in the operational effectiveness in its controls over the process of estimating revenues and costs under the NMCI Contract. On May 13, 2003, EDS held its first quarter 2003 earnings conference call with investment analysts, during which the new CFO disclosed that as part of EDS' review of the NMCI account, the Company and its outside auditors reviewed the internal controls for this account and identified certain "significant deficiencies" in their operations. Jordan further admitted during the call that, in addition to the NMCI Contract, other "problem" contracts cost EDS an additional 9 cents EPS in the quarter.

114. Finally, on or about May 15, 2003, EDS filed with the SEC its quarterly report on Form 10-Q for the period ended March 31, 2003 ("Q1 2003 10-Q"), which provided the most complete disclosure on its losses relating to the NMCI Contract to date. Specifically, the Company reported that

the $334 million loss "resulted from a decline in the average seat price based on the type seats ordered and expected to be ordered by the DON [Department of the Navy], *as well as the reduced period of time in which to generate seat revenue due to deployment delays and associated incremental estimated operating costs*." (emphasis added)

115. The Q1 2003 10-Q also expanded on the "significant deficiencies" referenced in the Company's first quarter 2003 earnings call. Management disclosed that, upon undertaking *its own* review of the NMCI Contract, it discovered deficiencies in the operational effectiveness of EDS' controls over estimating revenues and costs with respect to that contract. Upon review, its auditors determined the deficiencies were "significant" and constituted a reportable condition:

> [M]anagement sought to determine, among other things, whether there are any "significant deficiencies" or "material weaknesses" in the design or operation of internal controls. In professional auditing literature, "significant deficiencies" are referred to as "reportable conditions," which are control issues that could have a significant adverse effect on the ability to record, process and summarize and report financial data in financial statements. Auditing literature defines "material weakness" as a particularly serious reportable condition where the internal controls does not reduce to a relatively low level the risk that misstatements caused by the error or fraud may occur in amounts that would be material in relation to the financial statements and the risk that such misstatements would not be detected within a timely period by employees in the normal course of performing their assigned functions.
>
> *As a result of a review of the NMCI Contract completed after the first quarter of 2003, management and the Audit Committee of our Board of Directors discovered deficiencies in the operational effectiveness of controls over the process for estimating revenues and costs for the remaining term of the NMCI Contract*. Our independent auditors reviewed these matters and advised the Audit Committee that, due to the size of the NMCI Contract they collectively constitute a significant deficiency that rises to the level of a reportable condition. (emphasis added.)

116. The Company further disclosed that management had taken significant steps to correct and improve the effectiveness of the internal controls for the NMCI Contract, including:

increased frequency and scope of operational and financial reviews with senior account and corporate personnel; a newly-staffed program management office, stricter adherence to the process for approval of change orders; reorganization of account support functions and the appointment of a senior service delivery executive; assignment of additional finance and legal staff to the account; improvements in monitoring and reporting seat deployment; and improved communication with senior client representatives.

117. The Q1 2003 10-Q also disclosed that the SEC, which was continuing its Formal Investigation of the Company's events leading to EDS' disastrous third quarter 2002 earnings announcement, had requested additional information relating to the NMCI Contract.

CLAIMS FOR RELIEF

COUNT I

(Violations Of Section 10(b) Of The Exchange Act And Rule 10b-5 Promulgated Thereunder Against All Defendants)

118. New Jersey repeats and realleges each of the allegations set forth in the foregoing paragraphs as if fully set forth herein.

119. Throughout the Class Period, defendants individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about EDS, including its true financial results and business operations, as specified herein. Defendants employed devices, schemes, and artifices to defraud while in possession of material, adverse non-public information and engaged in acts, practices, and a course of conduct that included the making of, or participation in the making of, untrue and/or misleading statements of material facts and/or omitting to state material facts necessary in order to make the statements made about EDS not misleading. Specifically, defendants knew or, but for their severe recklessness, should have known that the Company's reported financial results for

Fiscal 2000, 2001 and the first two quarters of 2002, as filed with the SEC and disseminated to the investing public during the Class Period, were materially misstated and were not presented in accordance with GAAP. Further, defendants knew of existing adverse facts which undermined their representations about EDS' operations.

120. Brown and Daley, as senior executive officers of the Company, are liable as direct participants in the wrongs complained of herein. Through their positions of control and authority as officers of the Company, each of the Individual Defendants was able to and did control the content of the public statements disseminated by EDS. With knowledge of the falsity and/or misleading nature of the statements contained therein and in severely reckless disregard of the true financial results of the Company, the Individual Defendants caused the heretofore complained of public statements to contain misstatements and omissions of material facts as alleged herein.

121. Defendants acted with scienter throughout the Class Period, in that they either had actual knowledge of the misrepresentations and/or omissions of material facts set forth herein, or acted with severely reckless disregard for the truth in that they failed to ascertain and to disclose the true facts, even though such facts were available to them. Brown and Daley were among the senior management of the Company, and were therefore directly responsible for the false and misleading statements and/or omissions disseminated to the public through press releases, news reports, and filings with the SEC.

122. Defendants' misrepresentations and/or omissions were intentional or severely reckless and done for the purpose of enriching themselves at the expense of New Jersey and the Class and to conceal the Company's true operating condition from the investing public. Defendants engaged in this scheme to inflate the Company's reported revenues and earnings in order to create the illusion that EDS was a

successful, strong and growing IT outsourcing company.

123. As a result of those deceptive practices and false and misleading statements and/or omissions, the market price of EDS' common stock was artificially inflated throughout the Class Period. In ignorance of the false and misleading nature of the representations and/or omissions described above and the deceptive and manipulative devices employed by defendants, New Jersey and the other members of the Class, in reliance on either the integrity of the market or directly on the statements and reports of defendants, purchased EDS common stock at artificially inflated prices and were damaged thereby.

124. Had New Jersey and the other members of the Class known of the material adverse information not disclosed by defendants, or been aware of the truth behind defendants' material misstatements, they would not have purchased EDS common stock at artificially inflated prices.

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

COUNT II

(Violations of Section 20(a) Of The Exchange Act Against The Individual Defendants)

126. New Jersey repeats and realleges each of the allegations set forth in the foregoing paragraphs as if fully set forth herein.

127. New Jersey brings this claim against defendants Brown and Daley.

128. Defendant Brown by virtue of his position with EDS and his specific acts was, at the time of the wrongs alleged herein, a controlling person of EDS within the meaning of Section 20(a) of the Exchange Act. He had the power and influence and exercised the same to cause EDS to engage in the

illegal conduct and practices complained of herein.

129. Defendant Daley, by virtue of his position with EDS and his specific acts was, at the time of the wrongs alleged herein, a controlling person of EDS within the meaning of Section 20(a) of the Exchange Act. He had the power and influence and exercised the same to cause EDS to engage in the illegal conduct and practices complained of herein.

130. By reason of the conduct of EDS as alleged in this Complaint, defendants Brown and Daley are liable for the aforesaid wrongful conduct of EDS and are liable to New Jersey for the substantial damages which they suffered in connection with their purchases or acquisitions of shares as a result of EDS' violations of the Exchange Act.

PRAYER FOR RELIEF

WHEREFORE, New Jersey prays for relief and judgment, as follows:

131. Determining that this action is a proper class action and certifying New Jersey as a Class representative under Rule 23 of the Federal Rules of Civil Procedure;

132. Awarding compensatory damages in favor of New Jersey and the other Class members against all defendants for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including prejudgment and post-judgment interest thereon;

133. Awarding New Jersey and the Class their reasonable costs, expenses and attorneys' fees incurred in connection with this action; and

134. Awarding such other and further relief as the Court finds just and proper.

JURY DEMAND

New Jersey demands a trial by jury.

Dated: July 7, 2003

Respectfully submitted,

NICKENS, KEETON, LAWLESS,
FARRELL & FLACK, LLP

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JACKS C. NICKENS (Bar No. 15013800)
600 Travis, Suite 7500
Houston, Texas 77002
Tel: (713) 571-9191
Fax: (713) 571-9652

Liaison Counsel

BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP
ALAN SCHULMAN
ROBERT S. GANS
12544 High Bluff Drive, Suite 150
San Diego, CA 92130
Tel: (858) 793-0070
Fax: (858) 793-0323
-and-
EDWARD A. GROSSMANN
1285 Avenue of the Americas
New York, NY 10019
Tel: (212) 554-1400
Fax: (212) 554-1444

Lead Counsel

GREENBAUM, ROWE, SMITH, RAVIN,
DAVIS & HIMMEL LLP
MICHAEL B. HIMMEL
ROBERT J. KIPNEES
Metro Corporate Campus 1
PO Box 5600

Woodbridge, NJ 07095
Tel: (732) 549-5600
Fax: (732) 549-1881

Co-Lead Counsel

78041.1