

additional substantial evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

Nature of the Action

2. Plaintiffs bring this action as a class action on behalf of a class (the "Class") consisting of themselves and all other persons or entities who purchased Xerox common stock during the period October 22, 1998 (when Xerox first claimed that it was benefitting from the restructuring) through October 7, 1999 (when Xerox finally disclosed the massive problems that affected its operations and the impact of these problems on its revenues), inclusive (the "Class Period"), seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act").

3. In April of 1998, Xerox announced a Company-wide restructuring by which it intended to consolidate its regional customer service centers into three central locations, eliminate approximately 9,000 jobs, and take a \$1.6 billion charge before taxes to account for the restructuring.

4. This aggressive consolidation saved costs by, among other things, under-staffing the Company's remaining customer service locations with unskilled employees to handle the jobs of sales support, order processing, and customer follow-up. These overwhelmed and unprepared workers failed to do the job. The failure of these functions quickly impacted sales, shipment of products, and customer relationships. These essential operations continued to deteriorate throughout the second half of 1998 and all of 1999.

5. Throughout the Class Period, the customer service operations also deteriorated because the Company's sales personnel were required to assume paperwork and follow-up tasks

that had been handled by the service centers prior to the restructuring. Sales representatives spent almost half their time on paperwork and dealing with complaints, instead of selling. Customers grew frustrated with delays in product shipment and poor customer service. Invoices were incorrect and Xerox overcharged customers. Xerox made fewer sales, lost pending sales, and ultimately lost customer relationships. This breakdown in Xerox's operations was widespread throughout the Company.

6. During the Class Period, defendants, while informing investors about the cost savings from the restructuring and claiming its financial and operational benefits, failed to disclose the material negative impact that the restructuring had on the Company's operations and revenue. In January of 1999, with knowledge or reckless disregard of the above-stated problems, defendants made additional statements concerning the restructuring to investors which they knew or recklessly disregarded were false. Shortly after making these particular statements, senior executives sold \$51.7 million of their Xerox stock.

7. It was not until October 8, 1999 that the Company fully disclosed that "sales productivity was affected by the continued realignment of the customer administration restructuring." This belated disclosure had a catastrophic effect on Xerox's stock. On that day the price of Xerox stock fell more than 25%, the largest single day drop in more than 20 years.

8. Analysts expressed dismay and skepticism with respect to Xerox's disclosure. One analyst, in summarizing the Company's admissions, stated: "[i]t calls into question the credibility of management."

Jurisdiction and Venue

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

10. This action arises under §§ 10(b) and 20(a) of the Exchange Act (15 U.S.C. §§ 78j(b) and 78t(a)) and Rule 10b-5 promulgated under § 10(b) by the SEC. (17 C.F.R. § 240.10b-5).

11. Venue is proper in this District pursuant to § 27 of the Exchange Act, and 28 U.S.C. § 1391(b). Many of the acts charged herein, including the preparation and dissemination of materially false and misleading information, occurred in substantial part in this District. Additionally, defendants maintained their chief executive offices and principal place of business within this District during the Class Period.

12. In connection with the acts alleged in this complaint, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the New York Stock Exchange ("NYSE"), a national securities exchange.

Parties

13. By order of the Court, Woodstock Corp., Shellsign & Co., Thomas Zanbito and Carol Zanbito, and Thomas Dalberth were appointed Lead Plaintiffs. Each of the Lead Plaintiffs purchased Xerox common stock at artificially inflated prices during the Class Period, as set forth in the Certifications previously filed with the Court and incorporated herein by reference, and were damaged thereby.

14. a. Defendant Xerox Corporation is a New York corporation with its principal executive offices located at Stamford, Connecticut, P.O. Box 1600, 06904-1600. Xerox purports to be the world's leading document processing company. The Company purports to develop, manufacture, market, service and finance a full range of products, services and solutions that allow businesses to increase productivity by creating faster and easier access to information and documents.

b. At all times relevant to this action, Xerox common stock was actively traded on the NYSE, a national securities exchange, under the ticker symbol "XRX" and was registered pursuant to §12 of the Exchange Act (15 U.S.C. § 78l). The market for the Company's common stock was therefore open, well-developed, and efficient at all relevant times. During the Class Period, Xerox filed annual, quarterly, and other reports with the SEC in accordance with the Exchange Act.

15. The following defendants are collectively referred to as the "Individual Defendants," and served at all times material to the claims set forth herein, in the following positions:

a. Defendant Paul Allaire ("Allaire") has served as Chairman of the Board of Directors since May 1999, Chief Executive Officer from May 1991 to April 1999, Chairman of the Executive Committee, and a Member of the Board of Directors since 1986. Defendant Allaire was paid an annual salary of \$975,000 in 1998 and 1999, and additional compensation in the amount of \$4,701,443 in 1998 and \$118,644 in 1999. During the Class Period, Defendant Allaire exercised 200,000 options for proceeds of \$11,818,740.

b. Defendant Richard Thoman ("Thoman") has served as President and Chief Operating Officer since June 1997, Chief Executive Officer since April 1999, a Member of the Executive Committee, and a Member of the Board of Directors since June 1997. Defendant Thoman was paid an annual salary of \$700,000 in 1998 and \$900,000 in 1999 and additional compensation of \$3,403,977 in 1998 and \$189,642 in 1999. During the Class Period, Defendant Thoman exercised 300,000 options for proceeds of \$18,353,005.

c. Defendant Barry Romeril ("Romeril") has served as Executive Vice President and Chief Financial Officer since 1993, Vice Chairman of the Board of Directors since April 1999 and a Member of the Board of Directors since April 1999. Defendant Romeril was paid an annual salary of \$513,333 in 1998 and \$575,000 in 1999 and was paid additional compensation of \$1,535,789 in 1998 and \$170,047 in 1999. During the Class Period, Defendant Romeril sold 20,524 shares of Xerox for proceeds of \$1,200,654.

16. It is appropriate to treat the Individual Defendants as a group for pleading purposes and to presume that the false, misleading and incomplete information conveyed in the Company's public filings, press releases, and other publications, as alleged herein, are the collective actions of the narrowly defined group of defendants identified above. Each of the above officers or directors of Xerox, by virtue of their high-level positions with the Company, directly participated in the day-to-day management of the Company, was directly involved in the daily operations of the Company at the highest levels, and was privy to confidential proprietary information concerning the Company and its business, operations, products, growth, financial statements, and financial condition, as alleged herein. The defendants were involved in drafting, producing, reviewing and/or disseminating, the false and misleading statements and information

alleged herein, and were aware or recklessly disregarded, that the false and misleading statements were being issued regarding the Company, and approved or ratified these statements, in violation of the federal securities laws.

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

18. The Individual Defendants participated in the drafting, preparation, and/or approval of the various public and shareholder and investor reports and other communications complained of herein and were aware of, or recklessly disregarded, the misstatements contained therein and omissions therefrom. Because of their Board membership and/or executive and managerial positions with Xerox, each of the Individual Defendants had access to the adverse undisclosed information about Xerox's business prospects and financial condition and performance, as particularized herein, and knew (or recklessly disregarded) that these adverse facts rendered the positive representations made by or about Xerox and its business, by the Company, materially false and misleading.

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

20. Each of the defendants is liable as a direct participant in a fraudulent scheme and course of business that operated as a fraud or deceit on Xerox common stock purchasers by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding Xerox's business, the true state of its impaired operations following the consolidation of its customer service centers and the further implementation of its restructuring, its actual growth, and the intrinsic value of Xerox common stock; and (ii) caused plaintiffs and other members of the Class to purchase Xerox common stock at artificially inflated prices.

Plaintiffs' Class Action Allegations

21. Plaintiffs bring this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of the Class, consisting of all persons who purchased Xerox common stock during the Class Period and who were damaged thereby. Excluded from the Class are defendants, the officers and directors of the Company, at all relevant times, members of their

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

22. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, Xerox common shares were actively traded on the NYSE. As of July 31, 1999, there were approximately 663.07 million shares of Xerox common stock issued and outstanding. While the exact number of Class members is unknown to plaintiffs at this time and can only be ascertained through appropriate discovery, plaintiffs believe that there are hundreds if not thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Xerox or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

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

24. Plaintiffs will fairly and adequately protect the interests of the members of the Class and have retained counsel competent and experienced in class and securities litigation.

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

- (a) whether the federal securities laws were violated by defendants' acts as alleged herein;

- (b) whether statements made by defendants to the investing public during the Class Period misrepresented material facts about the business, operations and financial statements of Xerox; and
- (c) to what extent the members of the Class have sustained damages and the proper measure of damages.

26. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

Substantive Allegations

Background

Xerox's April 7, 1998 Restructuring Announcement

27. From 1995 through 1998, the price of Xerox common stock consistently increased, reaching a price as high as \$ 54 5/32 per share¹ in March of 1998. However, in early 1998, it became clear that, to remain competitive, the Company needed to reduce its operating costs.

28. On March 25, 1998, *The Washington Times* published an article concerning an earlier report in the *Rochester Democrat and Chronicle* that Xerox planned to announce the elimination of 10,000 jobs by April 6, 1998. The article further reported:

"They [Xerox] need to be even tougher on efficiency because competition is pretty tough," said Bob Spremulli, an analyst at Teachers Insurance & Annuity Association-College Retirement Equities Fund Investment Management, which owned about 6.9 million Xerox shares as of December. "It's a revitalized organization

¹All stock prices have been adjusted to reflect the stock-split announced in January 1999.

which, *if it gets tougher on costs*, can do even better." [Emphasis added.]

* * *

The company has struggled, however, *to pare costs as it makes the transition* from old-style copiers that operate with lenses and light bulbs to the new digital models that can be upgraded to include scanners, fax machines and printers when connected to personal computers. [Emphasis added].

The April 1998 Consolidation

29. On April 7, 1998, Xerox officially announced, over the *Business Wire*, that it would engage in such a restructuring. Although the Company styled its restructuring as a pro-active move, it was, in fact, a response to the material deterioration of the market for Xerox's traditional products -- a problem observed by analysts and investors.

30. In connection with the restructuring, the Company announced, among other things, that it would consolidate customer service centers and lay-off 9,000 people, or approximately 11% of its entire workforce. In the press release, Xerox and defendant Allaire described the restructuring, stating, among other things:

The company will rationalize and consolidate functions and locations to reduce duplication and to *increase speed of response to the marketplace*. -- Overhaul administrative processes and associated resources to achieve significantly greater productivity and speed of implementation. For example, Xerox will close one of four geographically-organized U.S. customer administrative centers with the remaining three re-focused by customer segment, enabling improved customer support *at lower cost*. When fully implemented the ongoing pre-tax savings from the initiatives will be approximately \$ 1 billion annually.

* * *

These initiatives will underpin the consistent delivery of double-digit revenue growth and mid- to high teens earnings-per-share growth. This restructuring is another step in our sustained strategy to lead the digital document world and provide superior customer and shareholder value. [Emphasis added.]

Undisclosed Adverse Material Facts

The Breakdown of Operations

31. Throughout the balance of 1998, Xerox's operations deteriorated as a result of the restructuring. The consolidation of the Company's customer service centers created three regional centers -- set up in Illinois, Texas, and Florida -- that were responsible for executing the core elements of Xerox's sales and customer support function. These centers recorded orders, booked revenue, and supported customers in the critical period immediately following the sale. In fact, Xerox consolidated not four centers into three, as it stated, but as many as 36 regional centers into three. This deception concealed from investors the actual magnitude of the undertaking.

32. As part of the restructuring, Xerox switched from a system in which sales orders were processed on a local level -- by experienced and skilled Xerox employees -- to a system in which the Company's national sales force was required to rely upon the three regional centers, each of which was staffed primarily by inexperienced employees. The consolidation brought specific negative effects on Xerox's sales, operations, and revenue process, which defendants were aware of, or recklessly disregarded at the time they were making the statements described further herein, yet failed to disclose.

33. Xerox primarily employed inexperienced and unskilled employees to staff its newly consolidated customer service centers. Many of its skilled workers, who had staffed such centers in the past, had refused to relocate to work at the three remaining centers. With the loss of skilled

