DAILY 07-18-02 DM M2 A1 CMYK

Weather
Today: *Humid, afternoon storms. High 94. Low 74.*
Friday: *Afternoon rain. High 90. Low 72.*
Details, Page **B8**

The Washington Post

FINAL
Inside: **Home, local news Extra**
Today's Contents on Page A2
35¢

125TH YEAR No. 225 M2 DM VA
THURSDAY, JULY 18, 2002
M1 M2 M3 M4 V1 V2 V3 V4
Prices may vary in areas outside metropolitan Washington. (See box on Page A4)

THE DEAL MAKERS
How AOL Hit Its Numbers

Unconventional Transactions Boosted Sales

Amid Big Merger, Company Resisted Dot-Com Collapse

First of two articles

By ALEC KLEIN
Washington Post Staff Writer

In October 2000, a critical question confronted America Online Inc. as it sought to clinch the largest merger in U.S. history: Was it feeling the effects of an industry-wide slowdown in advertising?

AOL's president at the time, Robert W. Pittman, offered a resounding answer: "I don't see it, and I don't buy it," he told Wall Street stock analysts and the media.

Other AOL officials were less optimistic. While overall revenue from online ads continued to grow rapidly, internal company projections raised caution about one sector: dot-coms. Failures were accelerating among those Internet start-ups, which represented a significant amount of the company's ad business.

About two weeks before Pittman's declaration on Oct. 18, he and other executives were told in a meeting at Dulles headquarters that AOL faced the risk of losing more than $140 million in ad revenue the following year.

That would equal only about 5 percent of AOL's proceeds from advertising and commerce. AOL projected that most dot-com clients would still be able to pay their bills. But the internal warning came when investors were highly alert to any weakness in online advertising. Just a week before Pittman's public statements, for example, shares of AOL's key competitor, Yahoo Inc., plunged 21 percent after the company reported strong ad growth but acknowledged that the pace could not be sustained. A day before Pittman spoke, AOL shares dropped 17 percent on what analysts described as similar worries.

In such an atmosphere, and with its takeover of Time Warner Inc. imminent, AOL sought to maintain its breakneck growth in advertising and commerce revenue. Besides selling ads on its online service for cash, AOL boosted revenue through a series of unconventional deals from 2000 to 2002, before and after the merger, according to a Washington Post review of hundreds of pages of confidential AOL

See **AOL**, *A16, Col. 1*

BY DUDLEY M. BROOKS—THE WASHINGTON POST

An airman salutes the casket of Gen. Benjamin O. Davis Jr. during the burial procession at Arlington National Cemetery.

Final Salute for Pioneering Hero

The Famous and Ordinary Honor Man Who Led Tuskegee Airmen

By STEVE VOGEL
Washington Post Staff Writer

It was the summer of 1926, and Ben Davis was 14 when his father paid $5 for a barnstorming pilot at Bolling Air Field in Washington to take his son for a ride.

By the time the plane landed, Benjamin O. Davis Jr. knew he wanted to be a pilot, a decision that would not only alter his life but have a profound impact on racial integration both in the U.S. military and in the country as a whole.

At Bolling Air Force Base yesterday, Davis, who died July 4 at age 89, was remembered as a pioneer and a hero who shattered racial myths as the commander of the famed Tuskegee Airmen in World War II and later as the first black general in the Air Force.

"It was here at Bolling Field that General Benjamin O. Davis Jr. gave birth to his dream to fly, and oh, what an aviator he became," Air Force Col. Harold Ray, a chaplain, said at the memorial service in the packed Bolling chapel. "It's only fitting that here at Bolling he take his final flight."

Davis's coffin, draped with an American flag, was later carried across the river to Arlington National Cemetery for burial with full military honors. Hundreds of mourners followed behind the horse-drawn caisson that carried the coffin in the hot July sun. Modern Air Force F-15 and F-16 fighters and vintage World War II air-

See **DAVIS**, *A10, Col. 1*

■ **Washington bids farewell to the National Gallery of Art's J. Carter Brown.** | *Page C1*

3 Civilians Die in Tel Aviv Bombing

2nd Attack in 2 Days Follows Month's Lull

By JOHN WARD ANDERSON *and* MOLLY MOORE
Washington Post Foreign Service

TEL AVIV, July 17—Two Palestinian suicide bombers detonated explosives outside a convenience store on a busy pedestrian walkway in an immigrant neighborhood of Tel Aviv tonight, killing themselves and three other people.

The bombings, which also injured 40, marked the second Palestinian attack against Israeli civilians in two days after a hiatus of nearly a month.

The bodies of the bombers, one clad in a red shirt, the other wearing blue, were found about 30 yards apart, according to Israeli police. Witnesses said the first bomber exploded himself near tables where customers were drinking beer and eating nuts. Some of the panicked victims, in trying to escape, raced headlong toward the accomplice, who then detonated his bomb.

"I was walking by the store with my daughter," said Benita Ustaris, 24, a housekeeper who moved from Bolivia four years ago. "There was an explosion, the first one. And then from the

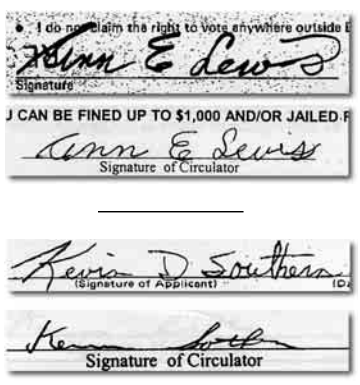
See **MIDEAST**, *A25, Col. 2*

■ **Arabs to give Bush a plan for Palestinians.** | *Page A24*

Questionable Signatures

Some signatures of petition circulators appear to be forged.

In each pair of signatures, the top is from a voter registration card, the bottom is from a questionable petition page.



THE WASHINGTON POST

Petition Workers' Names May Have Been Forged

By YOLANDA WOODLEE *and* CRAIG TIMBERG
Washington Post Staff Writers

Ann E. Lewis, who works security at an apartment building in Southeast Washington, decided to pick up a few extra dollars by collecting signatures for the reelection campaign of Mayor Anthony A. Williams. She asked residents to sign as they passed the reception desk, filling up parts of four petition pages—$55 for 55 signatures.

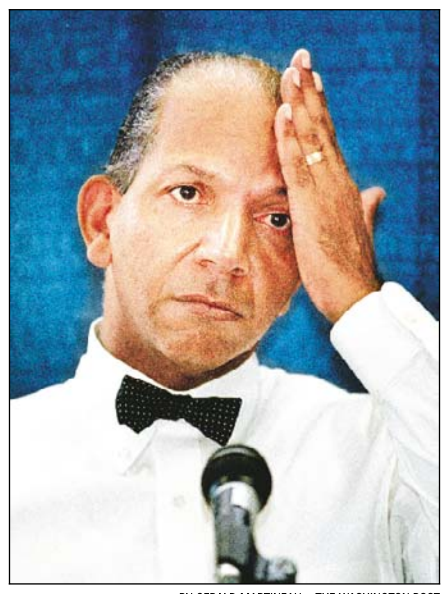
But the nominating petitions filed by the mayor's reelection campaign suggest that Lewis was far more prolific than she recalls. Eighteen pages of petitions bearing the signatures of 360 supposed voters were validated by her signature at the bottom—or the signature of someone pretending to be her.

"I definitely did not have 18 sheets," said Lewis, 64, who said she is still owed $15 by the campaign. "No way. If I find out people have forged my name, I'm going to sue somebody. I've never been involved in anything scandalous."

Williams yesterday accepted the resignation of his top campaign staffer, Charles N. Duncan, and put a second staffer on indefinite leave as punishment for their role in the petition crisis, which has jeopardized the mayor's plans to appear on the Democratic primary ballot in September.

He also acknowledged his respon-

See **MAYOR**, *A12, Col. 1*



BY GERALD MARTINEAU—THE WASHINGTON POST

"Mistakes were made by this mayor," Anthony A. Williams said yesterday at a news conference. He also announced the resignation of his top campaign staffer; another worker was put on indefinite leave.

Stock Declines Prompt Lifestyle, Portfolio Changes

By CAROLINE E. MAYER *and* CLAUDIA DEANE
Washington Post Staff Writers

James Oliver can still be found working in his Northwest Washington office—even though the 60-year-old cardiologist had hoped to be retired and living on San Diego's waterfront by now.

Elizabeth Medina of Queens, N.Y., shortened her family's summer vacation from eight days to four. And instead of taking their two young daughters to Walt Disney World near Orlando, Medina and her husband went to Tampa. "We'd have spent more money in Disney World," said the 38-year-old online service specialist.

Meanwhile, retired West Virginia government employee Frank Tolliver has decided not to replace some of the equipment on his 300-acre farm. "For a while I was feeling pretty flush," said Tolliver, who was heavily invested in technology stocks. Today, he added, "I certainly have less faith in the stock market."

The sharp decline of the stock market is slowly but steadily prompting many investors to make changes in the way they manage their money and even how they live from day to day. For some, plunging share prices have meant

See **INVESTORS**, *A18, Col. 1*

GOP Racing Ahead of President

Bush Response to Politically Perilous Issues Worries Lawmakers

By JIM VANDEHEI
Washington Post Staff Writer

Many Republicans, increasingly concerned that President Bush has been slow to address brewing controversies, are racing ahead of him on several fronts, most notably in efforts to rein in wayward corporations.

While still highly supportive of Bush in general, these Republicans believe he has failed to soothe public anxieties about the economy or to use the bully pulpit to protect their party from charges that it is soft on corporate wrongdoers who have contributed to the stock market's sharp fall. Several showed their anxiety this week by calling on Congress to embrace stiffer penalties for such executives than the president has proposed.

They are also advocating more money for the Securities and Exchange Commission and the Treasury Department to police corporations. Elsewhere, many congressional Republicans are pushing for more funding to combat AIDS, fight fires and fund other popular programs, which could complicate the president's campaign to hold down spending.

The decision to one-up the presi-

See **REPUBLICANS**, *A4, Col. 1*

INSIDE

Older Son Missing In SUV Blast Case
The older son of a D.C. executive whose car was blown up Friday is missing, police said. The executive's younger son was severely injured in the blast.
METRO, *Page B1*

Tiger Takes Aim At British, Grand Slam
Tiger Woods, who has won the first two legs of golf's Grand Slam, begins his quest for the third today at the 131st British Open at historic Muirfield in Scotland.
SPORTS, *Page D1*

Capital One Stock Plunges
Capital One stock fell nearly 40 percent after the Falls Church credit card company agreed with federal regulators to make changes regarding high-risk loans.
BUSINESS, *Page E1*

The Post on the Internet: www.washingtonpost.com

0 70628 21100 3

Ravers Against the Machine

Partiers and ACLU Take On 'Ecstasy' Legislation

By DAVID MONTGOMERY
Washington Post Staff Writer

Two young women on an urgent mission have been lugging boxes into the offices of U.S. senators this week. The boxes contain petitions an inch thick, one for each senator. Nearly 10,000 signatures were collected over the Internet in five days.

The petitions declare: "This bill is a serious threat to civil liberties, freedom of speech and the right to dance."

Look out, Congress: The ravers are coming.

"We're offended by the fact they're blackballing an entire musical genre," said Amanda Huie, checking senators' names off her list Tuesday afternoon.

The genre in question is electronic dance music, which fans enjoy at all-night parties called raves. Legislation in Congress could hold promoters responsible if people attending the events use illegal drugs such as Ecstasy, the party drug frequently associated with raves.

The Reducing Americans' Vulnerability to Ecstasy Act of 2002—or the RAVE Act—has cleared the Senate Judiciary Committee and is on the consent calendar, meaning it could receive final approval without a roll call vote at any time. When he introduced the bill in June, Sen. Joe Biden (D-Del.) said "most raves are havens for illicit drugs," and congressional findings submitted with the bill label as drug paraphernalia such rave mainstays as bottled water, "chill rooms" and glow sticks.

See **RAVE**, *A8, Col. 1*

Anger Rises Over a Speck of Land

BY RAMON ESPINOSA—ASSOCIATED PRESS

Moroccans in a coastal village protest Spain's takeover of a disputed islet, in background, that Moroccan soldiers occupied last week. Spanish soldiers landed before dawn and expelled the rival troops. Story, Page A22.

DAILY 07-19-02 DM M2 A1 CMYK

Weather
Today: *Humid, thunderstorms. High 92. Low 76.*
Saturday: *Some sun, chance of showers. High 88. Low 74.*
Details, Page **B10**

The Washington Post

FINAL
Inside: **Weekend**
Today's Contents on Page A2
35¢

125th Year No. 226 M2 DM VA
Friday, July 19, 2002
M1 M2 M3 M4 V1 V2 V3 V4
Prices may vary in areas outside metropolitan Washington. (See box on Page A2)

THE DEAL MAKERS | *AOL's Warrior Culture*

Creative Transactions Earned Team Rewards

Second of two articles

By Alec Klein
Washington Post Staff Writer

At noon on Dec. 21, 2000, David M. Colburn swaggered to the stage in black cowboy boots, sporting his trademark 5 o'clock shadow.

From the podium, Colburn, then president of business affairs at America Online Inc., beamed at his audience, about 100 employees assembled in the Seriff Auditorium at AOL headquarters in Dulles for the monthly all-hands meeting of his unit.

It was time to hand out the Bammy Awards.

A takeoff on television's Emmy Awards, the Bammys were given to the best performers in Colburn's division, a group of aggressive deal makers skilled in extracting maximum dollars from a prospective client. Business affairs—"BA," as it was known around AOL—was in the middle of many of the company's biggest and most complicated deals, which helped AOL reach or exceed its financial targets.

Theirs was a culture that grew increasingly important as America Online evolved from a Northern Virginia upstart into an online behemoth capable of taking over Time Warner Inc.

On this day, Colburn bestowed the Bammy's gold-star plaque on Kent Wakeford and Jason Witt, who had put together a complex transaction with PurchasePro.com Inc., a Las Vegas software maker.

According to several people at the meeting, Colburn praised the two men for what he called a "science fiction" deal to

See **AOL**, *A16, Col. 1*

BY FRANK ANDERSON—LEXINGTON (KY.) HERALD-LEADER

PurchasePro.com founder Charles E. Johnson Jr. in his pool in Las Vegas. AOL negotiated a complex deal with Johnson.

No. 2 Officer Quits At AOL Time Warner

Media Company Reorganizes Into 2 Groups

By Frank Ahrens
Washington Post Staff Writer

AOL Time Warner Inc. yesterday overhauled its corporate operations and accepted the resignation of its No. 2 officer as the world's largest media conglomerate sought to reassure investors who have watched the company's stock value and advertising revenue plummet for a year.

After a scheduled board meeting in Dulles yesterday, AOL Time Warner announced the departure of Robert W. Pittman, 48, the colorful, driven and sometimes abrasive media pioneer who helped create MTV 21 years ago and revive America Online before its 2000 merger with Time Warner Inc.

AOL Time Warner said it has organized its many businesses into two new groups; the heads of each report directly to chief executive Richard Parsons.

The top three corporate officers of AOL Time Warner now have deep Time Warner roots; the sole remaining AOL top-brass presence is Chairman Stephen M. Case. Though AOL remains in the corporation's name, the online powerhouse is now simply a unit, and a struggling one, of a division of a company starting to look more like the old Time Warner. Don Logan, chairman of Time Inc. and its 140-magazine empire, will head a new Media & Communications Group, which will include America Online, Time Inc., Time Warner Cable, the AOL Time Warner Book Group and Interactive Video unit. (Newsweek, a competitor of Time magazine, is owned by The Washington Post Co.)

Jeff Bewkes, chairman of HBO, will head the Entertainment & Networks Group, comprising HBO, New Line Cinema, the WB television network, Turner

See **PITTMAN**, *A17, Col. 1*

Mothers Who Nurse Have Less Breast Cancer Risk

Study Cites Disease Rate In Developed World

By Susan Okie
Washington Post Staff Writer

Breast-feeding is a major factor that helps to reduce a woman's lifetime risk of developing breast cancer, according to a new analysis of research data from 30 countries.

The relatively high breast cancer rates found in developed countries are largely explained by the fact that women in those countries have chosen to have few children and to breast-feed them briefly or not at all, according to the detailed analysis of 47 studies by a British research group.

"It's really the number of children and the duration of breast-feeding that is the key to the differences between developed and developing countries" in breast cancer rates, said Valerie Beral, an Oxford University epidemiologist who led the project. "It really changes the way one looks at the cause of breast cancer."

Researchers have long known that having a full-term pregnancy before the age of 30 lowers breast cancer risk and that having additional pregnancies further reduces the chances of developing the disease. For the first time, the analysis confirms that breast-feeding itself can protect against breast cancer.

"This is a spectacular piece of work," said Miriam Labbok, a senior adviser on infant and young child feeding at UNICEF in New

See **CANCER**, *A14, Col. 5*

Arab Diplomats 'Encouraged' After Meeting With Bush

BY RICH LIPSKI—THE WASHINGTON POST

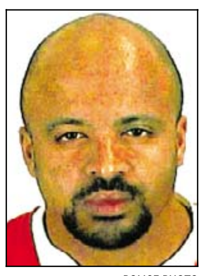
Saudi Foreign Minister Saud Faisal, left, and Egyptian Foreign Minister Ahmed Maher talk to reporters after discussing Mideast peace plans with President Bush. The White House called the session "a very good meeting." Story, Page A22.

Moussaoui Attempts Guilty Plea

Terror Suspect Says He Has Knowledge of Sept. Attacks

By Tom Jackman
Washington Post Staff Writer

Zacarias Moussaoui stepped to a lectern in a federal courtroom in Alexandria yesterday and declared that he is a member of al Qaeda and wants to plead guilty to his alleged role in the Sept. 11 attacks, claiming for the first time an intimate knowledge of the hijackings.



POLICE PHOTO

Zacarias Moussaoui said he seeks to "save my life."

But U.S. District Judge Leonie M. Brinkema declined to accept his request and said she would give him another week to decide whether he still wanted to plead guilty.

"Bet on me," Moussaoui shot back. "I will."

Moussaoui's reversal is the latest surprise in what has become a wildly unpredictable case ever since Brinkema allowed Moussaoui to serve as his own attorney beginning in April. It also puts the trial of the only person charged in the Sept. 11 attacks on the World Trade Center and the Pentagon into even more uncertainty.

Next week, Brinkema could accept Moussaoui's plea and move on to the phase of the proceedings that determines whether he will be executed. She also could again reject the plea and remove him as his own lead counsel—something she warned Moussaoui she might do minutes before he tried to plead guilty.

See **MOUSSAOUI**, *A11, Col. 1*

INSIDE

BY LARRY WATSON

Michael C. Hall and Peter Krause in the HBO series "Six Feet Under."

HBO Leads Emmy List

HBO's funeral parlor drama, "Six Feet Under," took 23 Emmy Award nominations yesterday, one more than NBC's "The West Wing." "Will & Grace" was the most nominated comedy.
STYLE, *Page C1*

Alaska's Big Thaw

Warming temperatures are causing Alaska's glaciers to melt at twice the rate researchers had thought, a new study finds.
NATION, *Page A14*

The Post on the Internet:
www.washingtonpost.com

0 70628 21100 3

United Way's Choice Refuses Top Job

By Peter Whoriskey
Washington Post Staff Writer

The man tapped last month to become the next board president of the United Way of the National Capital Area stunned the group's leadership Wednesday by declining the position, highlighting a crisis of confidence within the beleaguered charity a day after it learned it is under the scrutiny of federal investigators.

Anthony J. Buzzelli, a deputy managing partner at the accounting firm Deloitte & Touche, had been expected to boost the credibility of the regional charity in the face of growing skepticism from donors about its financial practices. Instead, his withdrawal set off a fractious meeting yesterday in which one trustee called for new management pending the federal probe, while another spoke of rising pressure on volunteers to cut their ties to the organization.

FBI agents delivered a grand jury subpoena Tuesday to United Way's offices in Southwest Washington, seeking the group's financial records and other data going back to 1997.

Buzzelli, who was to have been ratified as president yesterday at the organization's annual meeting, said his schedule of out-of-town travel prevented him from meeting the group's growing challenges.

"Eight weeks ago, when I said yes, I thought it was a stable period for the United Way," Buzzelli said in a telephone interview last night. "I was satisfied that everything that

See **UNITED WAY**, *A12, Col. 1*

Greece Catches Up to Elusive Terrorists

Arrests May Snuff Out November 17 Group

By Daniel Williams
Washington Post Foreign Service

ATHENS, July 18—When fire department helicopters swooped down on the Greek island of Lipsoi on Wednesday to battle a blaze, the men who swarmed out of the aircraft weren't firefighters. The conflagration had been set as a ruse, and the helicopter's passengers were Greek special police on the trail of one of Europe's most elusive terrorist groups.

Once on the ground, they quickly arrested Alexandros Giotopoulos, a former professor and reputed founder of Revolutionary Organization November 17, a group whose members had avoided arrest for more than a quarter-century.

Since a terrorist bomb exploded prematurely on an Athens street 19 days ago, delivering into police hands the injured man who had carried it, one lead has followed another. The trail led to Lipsoi, 160 miles east of Athens, and the arrest of Giotopoulos—alias Michael Oikonomous—and two others.

These and other detentions may open the door to solving 23 political murders, Greek officials and foreign diplomats said today. The victims have included four Americans, starting with the CIA's Athens station chief, Richard Welch, in 1975.

"All of these incidents of the past will be solved and fully solved," said a

See **GREECE**, *A20, Col. 3*

BY ARIS MESSINIS—ASSOCIATED PRESS

A police officer escorts Christodoulos Xiros, right, wearing a bullet-proof vest, outside an Athens courthouse.

Magaw Ousted From Airport Security Post

By Greg Schneider
Washington Post Staff Writer

John W. Magaw, the federal lawman President Bush picked to protect airports from terrorists, was forced to resign yesterday as chief of the Transportation Security Administration because of concern that his tough-cop approach was not working.

FILE PHOTO/ASSOCIATED PRESS

John W. Magaw headed the TSA.

The move is a midcourse attempt to rescue the government's effort to restore confidence in U.S. air travel. Six months after its founding, the TSA faced a budgetary challenge from Congress and near-rebellion by the aviation industry.

Transportation Secretary Norman Y. Mineta asked Magaw to resign yesterday after consulting with the White House, department sources said. Retired Adm. James M. Loy, former commandant of the Coast Guard and the No. 2 official at the TSA, was named to replace Magaw.

White House spokesman Ari Fleischer said that Magaw resigned "for health reasons," and that "the president very much appreciates the job that John Magaw did, taking an agency that had . . . no form to it and making great strides and progress on behalf of

See **SECURITY**, *A4, Col. 5*

■ **House GOP's security plan.** | *Page A4*

Weather
Today: *Cloudy, cool, a shower. High 78. Low 66.*
Friday: *Showers, humid. High 78. Low 70.*
Details, Page **B8**

The Washington Post

FINAL
Inside: **Home, local news Extra**
Today's Contents on Page A2
NEWSSTAND 35¢
HOME DELIVERY 28¢
Prices may vary in areas outside metropolitan Washington. (See box on Page A2)

125th Year No. 232 M2 DM VA
Thursday, July 25, 2002
M1 M2 M3 M4 V1 V2 V3 V4

Hill Leaders Agree on Corporate Curbs

Attack on Fraud Includes Auditing Control and Jail Terms; Markets Soar

BY PETER MORGAN—REUTERS

Traders laugh on the floor of the New York Stock Exchange yesterday as stocks staged a sharp comeback.

By Jim VandeHei *and* David S. Hilzenrath
Washington Post Staff Writers

House and Senate leaders, hoping to restore confidence in the scandal-tainted corporate world, agreed yesterday to broad new regulation of businesses and their auditors, and to stiffer penalties for those who commit financial fraud.

Marking the toughest new restrictions on accounting practices since the Great Depression, the legislation is intended to make it harder for corporate executives and auditors to deceive investors, who have lost trillions of dollars on the stock exchanges since the Enron Corp. scandal broke in October.

The package creates a new board to oversee the auditors of companies traded on the stock markets; limits accounting firms' ability to profit from doubling as consultants to the companies they audit; and gives shareholders more time to sue companies that misled them. The legislation also dramatically increases maximum fines and jail sentences for those who violate new and existing corporate laws.

The legislation emerged from six days of talks between House and Senate conferees, who largely adopted the Senate's broader proposals for cracking down on corporate fraud. Legislative leaders predicted the House and Senate will approve the measure by the end of next week, and President Bush signaled yesterday he will sign it into law.

"Traditionally our markets have been the fairest, most efficient and the most transparent in the world," said Sen. Paul S. Sarbanes

See CONFERENCE, *A10, Col. 1*

Dow Rises 489 As Stocks Surge

By Steven Pearlstein *and* Ben White
Washington Post Staff Writers

U.S. stock prices yesterday staged their biggest one-day rally in nearly 15 years as Congress moved toward passage of a corporate reform bill, fears of a banking crisis evaporated and many investors concluded that a brutal two-month sell-off had gone too far too fast.

The Dow Jones industrial average gained 488.95 points, or 6.4 percent. It was the second-biggest one-day percentage gain since the market crash of 1987, and the second-biggest point gain since the market peak of January 2000.

Trading on the New York Stock Exchange was the heaviest on record, with more than 2.7 billion shares trading hands.

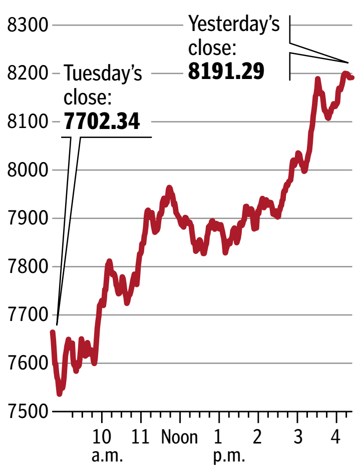
The broad, powerful rally began only after the Dow had fallen more than 170 points on the opening bell, snapping back 667 points during the course of the day.

Other indexes also posted strong gains, with the Standard & Poor's 500-stock index up 5.7 percent and the tech-heavy Nasdaq composite index up nearly 5 percent. Bond prices fell as investors shifted money into stocks and

See MARKETS, *A10, Col. 1*

What a Day

The Dow Jones industrial average rose more than 6 percent yesterday.



SOURCE: Bloomberg News

THE WASHINGTON POST

Analysis

Watchdogs' Vigilance Key to Bill's Success

By Jonathan Weisman *and* Albert B. Crenshaw
Washington Post Staff Writers

Congress stands on the brink of passing the most significant financial regulations in more than 60 years, but the legislation's true impact will be decided not by the lawmakers who wrote it but by the regulators it entrusts to oversee the corporate accounting industry.

Corporate lobbyists, consumer watchdogs and accounting experts agree that the deal struck by House and Senate negotiators yesterday will change the way America does business. Corporate auditors will no longer be policing themselves, but instead will have to submit to the wishes of an independent oversight board. The giant accounting firms will have less incentive to look the other way on their clients' creative bookkeeping because they will no longer be vying for lucrative consulting contracts. And chief executives will have to personally vouch for the earnings and profits their companies report each quarter, with the threat of prosecution hopefully keeping them honest.

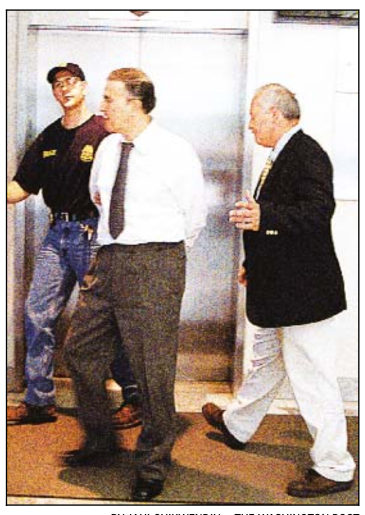
"This bill has got a lot of our CEOs nervous," said John Palafoutas, chief lobbyist for the American Electronics Association. "This thing has got some teeth in it. It's going to focus the mind."

But for each of these tough-sounding measures, there are serious caveats. Under the compromise legislation, the independent accounting oversight board is far more tethered to the Securities and Exchange

See ANALYSIS, *A10, Col. 5*

■ **Uproar over SEC chairman's promotion proposal.** | *Page E1*

■ **Fed shows no sign of lowering interest rates.** | *Page E1*



BY JAHI CHIKWENDIU—THE WASHINGTON POST

Lawyer Samuel G. Kooritzky, center, is accused of submitting nearly 2,700 phony applications for "labor certifications" for foreign workers.

Va. Men Charged In Visa Scheme

2,700 Fake Papers Filed, U.S. Says

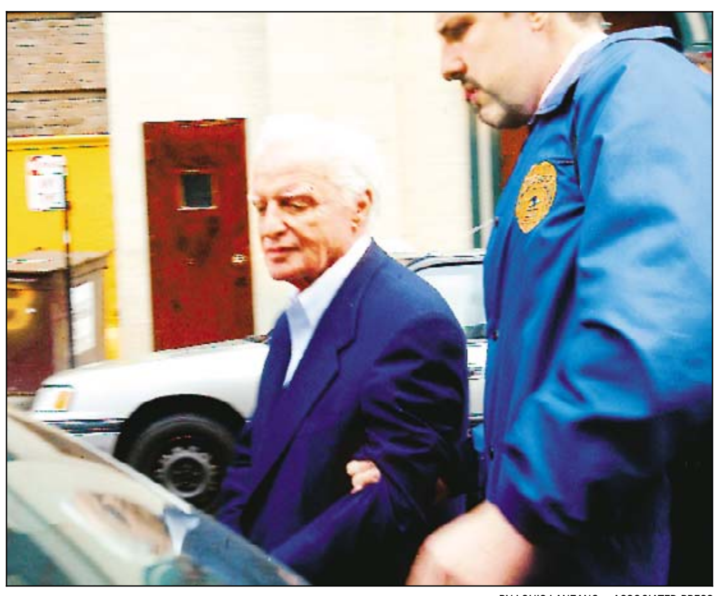
By Tom Jackman
Washington Post Staff Writer

Federal agents swarmed into Arlington yesterday and shut down a massive immigration fraud scheme that allowed thousands of illegal immigrants to obtain permission to work in the United States—and made millions of dollars for an Arlington lawyer and his colleague—prosecutors said.

Samuel G. Kooritzky, 63, an immigration lawyer and owner of the Capital Law Centers, and Ronald W. Bogardus, 65, an engineer, had submitted nearly 2,700 phony applications since the beginning of last year for "labor certifications" from the state and federal government, according to a 60-page affidavit filed in federal court in Alexandria yesterday. The documents certify that an employer needs a foreign worker for a job because no U.S. citizens are available. Once the Department of Labor issues a certification for a worker, the immigrant can apply to the Immigration and Naturalization Service for permanent residency.

Kooritzky allegedly charged immigrants at least $8,000 to file the paperwork. The two men, who are

See VISA, *A14, Col. 2*



BY LOUIS LANZANO—ASSOCIATED PRESS

John J. Rigas, founder of Adelphia, is led to a court appearance in New York yesterday by a U.S. Postal Inspection Service officer.

Adelphia Founder, Sons Charged

Family Looted Sixth-Largest Cable TV Company, U.S. Says

By Carrie Johnson *and* Christopher Stern
Washington Post Staff Writers

Federal authorities yesterday arrested five former executives of Adelphia Communications Corp., including the founder and two of his sons, and charged them with defrauding investors out of billions of dollars by using the cable television company as their "personal piggy bank."

The Justice Department and the Securities and Exchange Commission each filed complaints against John J. Rigas, who started Adelphia half a century ago, his two sons and two other former company executives in U.S. District Court in Manhattan. The SEC also charged in a civil action that Adelphia broke securities laws and failed to cooperate with its investigation.

Rigas, 78, and his sons Michael, 48, and Timothy, 46, were arrested and handcuffed by Postal Service inspectors yesterday morning at a Manhattan apartment.

The complaints allege that Adelphia laid out $13 million to build a golf course on John Rigas's land, paid for Manhattan apartments used by Rigas family members, covered hundreds of millions of dollars of the family's stock losses, and provided company airplanes for a Rigas African safari and other trips without reimbursing the firm—all without disclosing the transactions to outside board members or investors. Prosecutors also say the executives produced false documentation to hide debt and obscure the true financial condition of the company.

Adelphia, the nation's sixth-largest provider of cable television service, sought bankruptcy protection last month. The Coudersport, Pa., company disclosed in March that it

See ADELPHIA, *A11, Col. 1*

Williams Could Miss Primary Ballot

By Craig Timberg *and* Yolanda Woodlee
Washington Post Staff Writers

D.C. election board Chairman Benjamin F. Wilson suggested yesterday that forgeries and other problems are so widespread in the nominating petitions of Mayor Anthony A. Williams that he may be kept off the Democratic primary ballot.

In dismissing one of two challenges against Williams because it alleged that every signature was forged, Wilson caused a stir in the crowded hearing room when he said, "There is a significant number—albeit at this point I don't believe 2,000—that appear to not be forgeries."

Wilson later sought to clarify the remark by saying that the board staff's signature-by-signature review had not found enough valid ones after examining 80 to 85 percent of the 5,800 the mayor says are valid. The overall results of this review have not yet been made public.

Williams needs 2,000 valid signatures of registered city Democrats to get on the Sept. 10 primary ballot.

The mayor's lead attorney, Vincent Mark J. Policy, continued to express confidence that Williams would end up with more than

See MAYOR, *A12, Col. 1*

House Votes 420 to 1 To Expel Traficant

By Juliet Eilperin
Washington Post Staff Writer

The House voted overwhelmingly last night to expel Rep. James A. Traficant, an Ohio Democrat who taunted foes for years with bombastic floor speeches but now faces a likely prison term on felony convictions for bribery and corruption.

Traficant, scheduled to be sentenced Tuesday, became only the second House member since Reconstruction to be expelled. The House ousted Rep. Michael "Ozzie" Myers in 1980 for accepting money from an FBI agent posing as an Arab sheik.

While most lawmakers facing expulsion have chosen to resign, Traficant fought his political death sentence until the end.

"I'll go to jail before I'll resign and admit something I didn't do," Traficant said. "I'll be damned if I'll be pressured by a government that pressured these witnesses to death."

Traficant walked out of the chamber before the House voted 420 to 1 to oust him, with nine voting present. Rep. Gary A. Condit (D-Calif.), who lost his primary this year after revelations surfaced concerning his relationship with slain intern Chandra Levy, was the only member to vote against expulsion.

Known for his spiky gray hair, an outdated polyester wardrobe and floor speeches littered with references to "Star Trek" and his anatomy, the nine-term House member railed against the government and the Washington establishment during the three-hour debate.

See TRAFICANT, *A4, Col. 2*

The Post on the Internet: www.washingtonpost.com

AOL Time Warner Discloses SEC Probe

By Alec Klein
Washington Post Staff Writer

AOL Time Warner Inc. disclosed yesterday that the Securities and Exchange Commission has launched a probe into its accounting practices after questions were raised about how the company generated revenue through a series of unconventional deals.

The world's largest media company said that its accounting was proper and that all the transactions were approved by its outside auditor. But its chief executive and chief financial officer vowed to give investors a better understanding of the business, beginning yesterday with more detailed disclosures about its online division, including its advertising and commerce revenue, as part of AOL Time Warner's announcement of second-quarter financial results.

The company performed slightly better than analysts had expected, reporting a 10 percent gain in revenue, driven in large part by its content businesses, including its moviemaking division, and its cable television network.

The Dulles-based online division, however, remains a concern as its advertising and commerce revenue continued to drop and its subscription growth rate came in short of analysts' expectations.

As part of yesterday's earnings announcement, chief executive Richard D. Parsons said AOL Time Warner contacted the SEC after the company received a series of questions from The Washington Post about its business practices both before and after America Online's January 2001 acquisition of Time Warner.

"After the [Post] articles came

See AOL, *A8, Col. 1*

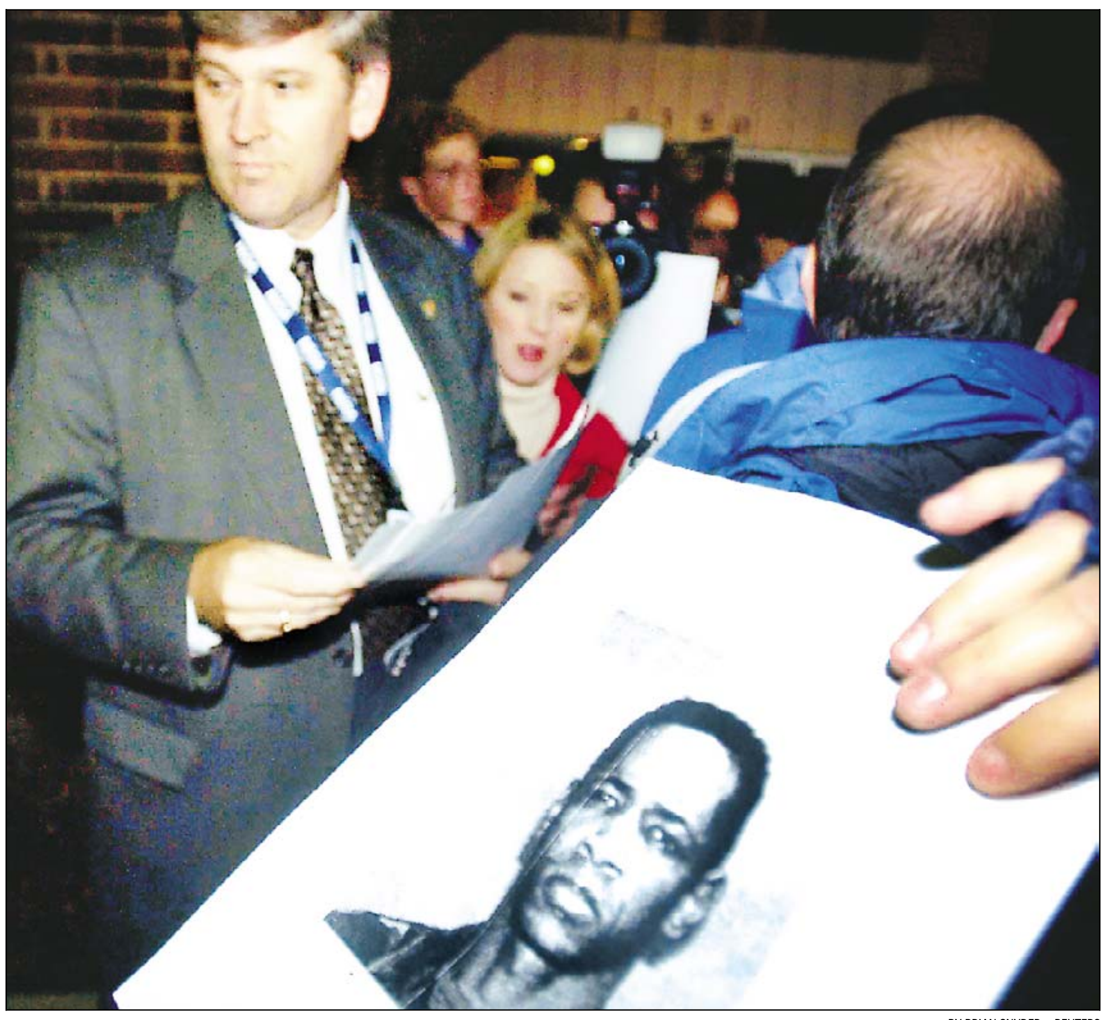
Weather
Today: *Cooler, rain later. High 51. Low 42.*
Friday: *Breezy, rain. High 48. Low 45.*
Details, Page **B8**

The Washington Post

FINAL
Inside: **Home, local news Extra**
Today's Contents on Page A2
NEWSSTAND 35¢
HOME DELIVERY 28¢
Prices may vary in areas outside metropolitan Washington. (See box on Page A2)

125th Year No. 323 M3 DM VA K
Thursday, October 24, 2002
M1 M2 M3 M4 V1 V2 V3 V4

Police Look for Former Soldier For Questioning in Sniper Case



BY BRIAN SNYDER—REUTERS

Officials hand out photographs of John A. Muhammad, whom police want to question. They say he was linked to the sniper case in a telephone communication last week from the man who police believe is the gunman.

Moose Appeals to Gunman To Communicate Further

By Sari Horwitz, Dan Eggen *and* Michael E. Ruane
Washington Post Staff Writers

Investigators yesterday were seeking a man in connection with the deadly sniper shootings that have terrorized the Washington area, even as Montgomery County Police Chief Charles A. Moose followed the sniper's mandate at a televised briefing and made reference to "a duck in a noose."

Moose said police wanted to question John Allen Muhammad, a former Army soldier once known as John Allen Williams, who had been linked to the case in a telephone communication last week from a man who police believe is the sniper.

"We believe that Mr. Muhammad may have information material to our investigation," Moose said in a briefing just before midnight.

Moose cautioned that Muhammad may not be directly involved with the shootings. Muhammad and a juvenile companion, identified by sources as Lee Malvo, 17, were the subject of an intense manhunt last night.

He described Muhammad, 41, as "armed and dangerous" and said he was wanted on a federal firearms charge. But Moose added "a strong word of caution: Do not assume from this allegation that John Allen Muhammad . . . is involved in any of the shootings we are investigating."

The developments occurred on a day when the fatal shooting of a Montgomery County bus driver was ballistically linked to the sniper responsible for nine other killings in the Washington area. As children were shepherded to school by fearful parents yesterday, details emerged of a second letter in which the sniper threatened to harm children.

Police sources said yesterday that in one of a flurry of contacts—including phone calls and two letters that made references to "we" and "us"—the sniper made a number of demands for money and at least one curious request. Moose responded with a direct statement last night.

"We understand that you communicated with us by calling several different locations," Moose said. "Our inability to talk has been a

See SNIPER, *A12, Col. 1*

AOL To Revise Financial Results

Online Ad Deals Inflated Earnings

By David A. Vise *and* Alec Klein
Washington Post Staff Writers

AOL Time Warner Inc. announced yesterday that it will revise its financial results for a two-year period occurring before and after its merger in January 2001 to account for online ad sales and other deals that improperly inflated revenue by $190 million and one measure of profitability by $97 million.

The company said it discovered the problems during an internal review of its books and records that was launched after the Securities and Exchange Commission and the Justice Department opened probes into its accounting. The company declined to identify the deals involved, but said they occurred between July 1, 2000, and June 30 of this year.

"Even though the total amount of the restatement represents a small portion of America Online's total revenues during this period, we have taken, and do take, this matter very seriously," said chief executive Richard D. Parsons.

Parsons said the company will share the results of its review with federal investigators. The company's decision to publicly restate its financial results now, before the federal investigations are completed, is likely to be looked upon favorably by the SEC, according to sources familiar with the investigation. But the move is unlikely to influence the criminal investigation, which appears to be focused more on possible wrongdoing by individual executives than on the company itself, sources said.

Yesterday's disclosure is an about-face for New York-based AOL Time Warner, which had initially stood by the accuracy of its accounting in the wake of a Washington Post report in July describ-

See AOL, *A6, Col. 1*

A Distant Search for Clues

Agents Look for Bullets Fired in Back Yard on West Coast

Authorities Seeking 'Person of Interest'

FBI and local police are searching for information on the whereabouts of:

JOHN ALLEN MUHAMMAD
- Also known as John Allen Williams.
- Considered armed and dangerous.

Anyone with information should call **911**, or the tip line at **888-324-9800**.

By Amy Shipley *and* Steve Vogel
Washington Post Staff Writers

TACOMA, Wash., Oct. 23— The investigation into the sniper terrorizing the Washington area jumped across the country today as federal agents combed through a yard here, looking for shell casings and bullet fragments that may have been fired by a man police want to question in connection with the case, law enforcement sources said.

Agents armed with chain saws, metal detectors and heavy equipment removed a tree stump containing a bullet fragment and other evidence from the yard, officials said.

Startled neighbors said agents from the FBI and the federal Bureau of Alcohol, Tobacco and Firearms swarmed the home this morning.

FBI spokeswoman Melissa Mallon said the property owner consented to the search. She refused to say why agents were there.

A law enforcement source said the man police are looking for—John Allen Muhammad, also known as John Allen Williams—may have used the tree stump for target practice and investigators want to remove any bullets or bullet fragments to compare them with the .223 bullets used by the Washington sniper. Police said Muhammad may be traveling with a 17-year-old named Lee Malvo. A witness saw one of them firing an assault-type rifle at trees in the yard, according to a law enforcement source.

FBI agents also visited Bellingham High School, about 100 miles north of here, today seeking information on Malvo, who once attended the school, officials said. They also served search warrants in Alabama in connection with the same investigation, sources said.

Chris Waters, 23, a soldier at Fort Lewis, who lives across the

See SEARCH, *A13, Col. 1*

BY MICHAEL LUTZKY—THE WASHINGTON POST

Montgomery County Police Chief Charles A. Moose's message to the sniper at 11:52 p.m. yesterday:

"We understand that you communicated with us by calling several different locations. Our inability to talk has been a concern for us, as it has been for you. You have indicated that you wanted us to do and say certain things. You asked us to say, 'We have caught the sniper like a duck in a noose.' We understand that hearing us say this is important to you. However, we want you to know how difficult it has been to understand what you want because you have chosen to use only notes, indirect messages and calls to other jurisdictions. The solution remains to call us and get a private toll-free number established just for you. We still ask you to call or write us at P.O. Box 7875, Gaithersburg, Md. 20898-7875. If you are reluctant to contact us, be assured that we remain ready to talk directly with you. Our word is our bond. If we can establish communications with you, we can offer other means of addressing what you have asked for. Let's talk directly. We have an answer for you about your option. We are waiting for you to contact us."

■ **Previous messages from Moose to the sniper.** | *Page A12*

Rebels Hold Hundreds Hostage In Moscow

Chechen Gunmen Take Over Theater

By Peter Baker *and* Susan B. Glasser
Washington Post Foreign Service

MOSCOW, Oct. 24 (Thursday)—A large group of armed Chechen rebels stormed a crowded Moscow theater Wednesday night, taking hostage as many as 700 people in the audience for a popular musical and demanding an end to Russia's long-running war in the separatist southern republic.

Witnesses reported gunfire when the group of about 40 men and women, armed with automatic weapons and wearing camouflage uniforms and masks, seized the hall after 9 p.m. They said the hostage-takers had grenades strapped to their bodies and said they were prepared to blow up the building if it were stormed by troops and police.

Hours later, a standoff appeared to have set in and continued through the night as hundreds of Russian soldiers and police, ambulances and firetrucks surrounded the massive theater not far from central Moscow. By early this morning, area residents were being evacuated in buses.

About 9:10 a.m., an explosion was heard in the vicinity of the theater. However, authorities would not describe what had happened.

A spokesman for the city police confirmed that the hostage-takers were Chechens and said they were holding more than 650 people in the theater after releasing about 150 others. The spokesman, Valery Gribakin, said that at least one woman was

See MOSCOW, *A32, Col. 1*

Half of Area Residents in Fear, Post Poll Finds

Children Anxious; Parents Feel Helpless

By Jacqueline L. Salmon *and* Ylan Q. Mui
Washington Post Staff Writers

Shortly after the sniper shootings began, Michelle Yu's 10-year-old daughter, Catherine, crept into her older sister's room and took her big stuffed dog Schubert, a family favorite. Now Catherine sleeps with the dog nestled safely between her head and the top of the bed.

"I said, 'Silly girl, why do you let Schubert take up all the space?' " said Yu, who lives in Potomac. "She said, 'Mommy, Schubert can protect me so that the bullet can't get into my head.' "

The shootings that have left 10 people dead and three seriously wounded in the last three weeks have terrorized much of the Washington area, but most of all, its youngest and most vulnerable residents.

The apparent randomness of the attacks, their wide geographic distribution, the fact that one victim was a 13-year-old boy and, most recently, the revelation that the sniper has made a vague but direct threat against children have deeply traumatized some youngsters, according to parents, therapists and pediatricians interviewed across the region yesterday.

"Your children are not safe anywhere at any time," read the disturbing postscript on the note left at the scene of Saturday night's shooting in Ashland, Va., and revealed Tuesday evening by Montgomery County Police Chief Charles A. Moose.

Yesterday morning, Darby Gingery's son, Gunnar, 12, appeared at the breakfast table with a copy of the newspaper carrying stories on the

See CHILDREN, *A16, Col. 1*

Routines Altered as a Precaution

By Richard Morin *and* Claudia Deane
Washington Post Staff Writers

Half of all Washington area residents fear they could become a victim of the serial sniper, whose murderous three-week rampage has spread anger, fear and anxiety throughout the region and altered the way many people work, shop and play, according to a Washington Post poll.

The survey found that 50 percent of those interviewed were at least somewhat fearful of falling victim to the sniper and that 28 percent were at least a little concerned. Only one in five—19 percent—said they had no fear of becoming the sniper's next victim.

A larger proportion of Washington area residents—more than four in 10—said the sniper shootings made them feel more personally threatened than did either the Sept. 11 attacks or the anthrax scare, according to the poll completed last night, before police identified a man wanted for questioning in connection with the sniper incidents. A juvenile companion is also being sought.

"It's been kind of frightening and scary at times," said Tony Banks, 33, an administrative clerk living in Lanham. "Before I get scared, I get angry."

"I don't live in New York; I don't work at the Pentagon," said a 52-year-old Bladensburg resident who was so frightened by the sniper that she declined to give her name. "But the sniper is going from Washing-

See POLL, *A15, Col. 1*

DAILY 10-24-02 DM SU A6 CMYK

Ad Deals Inflated AOL's Sales By $190 Million Over Two Years

AOL, *From A1*

ing several unconventional advertising and commerce transactions that totaled $270 million.

America Online Inc.'s success in generating ad revenue was one of the prime reasons that investors valued its stock so highly, pushing up the company's share price to enable AOL to pull off its merger with Time Warner Inc. and fashion the world's largest media company. But as the ad market slumped and accounting questions surfaced, AOL's fortunes changed. Many of AOL's top executives were pushed out or reassigned, and Time Warner hands asserted control of the company. The entire AOL operation is now part of a larger division instead of a corporate unit unto itself.

The Post report, based on hundreds of internal AOL Time Warner documents and company sources, detailed a series of deals that helped the Dulles-based online company boost its advertising and commerce revenue from 2000 to 2002, with many occurring around the time of the AOL-Time Warner merger. Among the transactions examined were two in which AOL converted legal awards into ad and commerce deals. In another instance, AOL served as a middleman, selling ads on behalf of eBay Inc. but booking all of the revenue as if it were AOL's own.

At the time AOL asserted that it had accounted for those deals properly, citing the work of its outside auditor, Ernst & Young LLC, which had confirmed AOL's financial statements when they were reported over the past two years. The company also took the additional step of asking Ernst & Young to recertify the numbers in light of the Post report, and the accountants did so, reiterating that AOL had properly reported its accounting.

"We were told our client has been conducting an internal review," said Les Zuke, spokesman for Ernst & Young. "There is really nothing I can say or add."

Within days of the Post report, the SEC and the Justice Department launched concurrent investigations into AOL's accounting. AOL Time Warner quickly restructured its operations, eliminating its business affairs division, which had engineered most of the ad deals in question. Then, in August, it fired its top business dealmaker, David M. Colburn, who had overseen business affairs and its the ad-revenue deals.

Later that month, AOL acknowledged that $49 million from three ad and commerce deals may have been inappropriately booked. Sources said those deals included a complex transaction with troubled WorldCom Inc., which is facing its own accounting scrutiny by federal authorities. Parsons also promised to provide investors and Wall Street with more transparency into the company's financial results.

Parsons declined yesterday to identify the three questionable deals or any others, citing the federal probes and the fact that AOL Time Warner is now the subject of several shareholder lawsuits. He added that the company did not expect to revise its financial statements further for the period in question.

"We have not only reviewed those three transactions but conducted an extensive review of AOL transactions from July 1999 to June 2002," he said. "This review has included large ad transactions. . . . The transactions reviewed comprise more than 70 percent of AOL's deals during that period."

The accounting disclosures come as AOL's sagging online business is dragging down the financial performance of the corporate parent, the world's biggest media company. Advertising revenue at AOL plummeted 48 percent and earnings fell 30 percent in the third quarter, the company said yesterday. With little confidence remaining in AOL on Wall Street, AOL Time Warner said it will hold a special "AOL Day" on Dec. 3 to outline a new business strategy and reassure investors about the division's future.

The only bright spot at AOL, which provides access to the Internet and exclusive content to 35.3 million computer users, was an increase of 206,000 subscribers in the quarter that ended Sept. 30, and a related 15 percent increase in subscriber revenue.

Parsons pledged to pay special attention to the future of the troubled online division.

"We haven't and won't diminish our focus on managing our company," he said. "Except for America Online, all of our businesses are doing quite well. . . . Our top operating priority remains turning

See AOL, *A7, Col. 1*

FILE PHOTO/BY SUZANNE PLUNKETT—ASSOCIATED PRESS

AOL Time Warner headquarters in Manhattan's Rockefeller Center. The media giant said it will revise its financial results for a two-year period before and after its January 2001 merger.

AOL Had Stood Behind Results

AOL, *From A6*

around America Online."

Parsons said the key to AOL's future was maintaining the loyalty of its subscribers, who pay $23.95 a month for the service. He said the release last week of the newest version of AOL software, AOL 8.0, reflected a "renewed focus" on members, adding that AOL 8.0 had been downloaded more than 5 million times, making this the company's best introduction ever of an updated version. Microsoft plans to release its new online software, MSN 8.0, today.

For the third quarter, AOL Time Warner as a whole, which owns highly profitable television, music and publishing properties, posted revenue of $10 billion, a 6 percent increase over the same period in 2001. A 13 percent jump in revenue from AOL subscriptions, cable and other businesses spurred the increase. Revenue from its other media businesses, led by home-video sales of "The Lord of the Rings," jumped 8 percent.

Overall, AOL Time Warner reported net income of $57 million (1 cent per share) in the third quarter, compared with a loss of $997 million (22 cents) in the same period of 2001. The company's financial results were hampered by the weak advertising performance at AOL, where the backlog of advertising and the sale of new advertising are both weak. Operating earnings for AOL Time Warner, which do not include interest, taxes and other expenses, fell 1 percent in the quarter, to $2.2 billion.

The restatement of earnings because of accounting problems reduced earnings before interest, taxes, depreciation and amortization (EBITDA), one common measure of profitability, by $97 million. It included $22 million in transactions between AOL and other parts of the AOL Time Warner empire. The adjustments represent 1 percent of AOL's revenue for the two-year period ended June 30, 3.4 percent of its ad and commerce revenue, and 1.9 percent of EBITDA. The biggest quarterly impact—$66 million in reduced revenue—was in the three months ended Sept. 30, 2000, only months before the AOL-Time Warner merger was consummated.

Muslim Charity Official Seeks U.S. Asylum

Associated Press

DETROIT, Oct. 23—The detained co-founder of an Islamic charity pleaded for U.S. political asylum today, saying he would be a target for both sides in the war on terrorism if he were deported to Lebanon.

Rabih Haddad, a Lebanese citizen, testified that al Qaeda supporters could persecute him for his vocal opposition to the terrorist group and the Sept. 11, 2001, attacks. He said he also feared action by the Lebanese government because of U.S. allegations linking him with terrorist activities.

Lebanon is "very eager to show the U.S. that they are one in the war against terrorism," Haddad said at an asylum hearing today before immigration Judge Robert Newberry. "There's no telling what they could do."

Haddad, who has been jailed since Dec. 14 on a visa violation, denies that he or his organization, Global Relief Foundation, have links to terrorists or related activities. The Bush administration has said it suspects Global Relief of having ties to terrorism, but no criminal charges have been filed against Haddad or the 10-year-old foundation.

The Ann Arbor resident, 41, is seeking asylum for himself and his family. The government also is trying to deport Haddad's wife, Salma al-Rushaid, and three of their four children. The judge is expected to issue a ruling Thursday.

Russian Economy Finally Feels the Heat

Market That Seemed Insulated From Western Woes Suffers Significant Drop

By Peter Baker
Washington Post Foreign Service

MOSCOW, July 24—The financial riptide that has swept through the United States and Western Europe reached Russia today, dragging down a market that until now had seemed relatively insulated from the swirling economic forces afflicting investors around the world.

The Russian Trading System (RTS) composite index fell 7.4 percent in brisk trading, taking with it some of the country's biggest companies, including energy-rich Gazprom, Sibneft, Yukos and Lukoil. The tumble took place hours before Wall Street rallied as investors here succumbed to panic selling after the severe losses elsewhere in recent days.

Despite today's turmoil, Russia has enjoyed an extraordinary recovery from the 1998 financial crisis brought on by its devaluation of the ruble and default on some debt. The country has expanded its economy, stabilized its currency, balanced its budget, enacted important reforms and curbed some of the worst excesses of its new capitalist kingpins. The market responded with a 50 percent surge in stock prices in the first five months of this year, making it one of the hottest in the world.

Through much of the downward spiral in more developed countries, Russia has been shielded by massive oil and gas reserves and the newfound optimism about its investment climate, but today's sell-off showed that ultimately it cannot ignore trends abroad.

"Growth is an optimistic concept and the world is full of fear," said James Fenkner, chief strategist at Troika Dialog brokerage house here. "Hope is definitely getting squeezed out of the market. We need some good news."

Analysts said Russia's fundamental economic conversion in recent years remains the most salient factor for long-term growth, and they expressed hope that Russia will shake off the global problems. "The market is currently tanking because of external factors," said Eric Kraus, a leading financial strategist here.

The underlying story offers a case study in how economic travails in the United States can influence even isolated markets. Like other emerging markets, Russia faces the prospect of losing ground even if it is doing what the West has advised it to do to develop a strong market economy.

Under President Vladimir Putin, Russia now runs a budget surplus, has been paying its foreign debt and has put into place a new land code allowing the sale of property. While business tycoons still enjoy considerable freedom to exploit former state assets and undercut foreign investors, Putin has stabilized the political system more than at any time since the collapse of the Soviet Union. The country has become something it was not at the time of the 1998 crisis: a generally more predictable, if not always fair, place to do business.

Foreign investors burned by the 1998 meltdown have begun returning. Ford Motor Co. recently opened a factory near St. Petersburg, and General Motors is working on one in partnership with a Russian firm. The U.S. Commerce Department last month finally designated Russia a market economy, with the statutory protections that status brings.

The rise of the RTS has reflected the changes. After plummeting to a disastrous low of 40 points during the worst of the crisis, it had climbed back to 277 by January of this year and soared to 420 in May. While still shy of its record of 563 in August 1997—the RTS closed today at 324.96, which is still up 17 percent for the year—the strong and steady rise has meant that many investors who stuck it out have recouped much of their lost wealth. The total market value of all Russian shares increased to $100 billion—still just one-fifth of the Frankfurt, Germany, market but an especially impressive figure for a country still building a stock market after 70 years of communism.

BY ALEXANDER ZEMLIANICHENKO—ASSOCIATED PRESS

A broker looks at trading terminals Monday in Moscow. Russian stock markets closed lower as investors succumbed to panic selling elsewhere.

"A lot of stocks are at or near their all-time high," said William F. Browder, chief executive officer of Hermitage Capital Management in Moscow. He said that even after today's drop, "Russia's held up surprisingly well, all things considered."

Despite the brightening picture, some investors continue to struggle with Russian partners who use murky practices to siphon money to foreign bank accounts or otherwise cheat foreign backers.

Gazprom, which supplies Western Europe with 25 percent of its gas, was among the hardest hit in trading today, falling 12 percent. Several large oil companies also fell significantly, including Sibneft (down 10 percent), Yukos (8 percent), Surgutneftegaz (8 percent) and Lukoil (5 percent).

The government announced today that it soon plans to sell 50 million shares of Lukoil, the country's largest oil producer, which recently disclosed a sharp drop in profits.

AOL Time Warner Discloses SEC Probe

AOL, *From A1*

out [last week], the SEC informed us that they are conducting a fact-finding inquiry," Parsons said in a conference call with Wall Street analysts and the media.

Parsons said "investor trust" is "fundamental to our future," and he promised the company would fully cooperate with the authorities. John Heine, an SEC spokesman, declined to comment.

The company disclosed the SEC inquiry after the close of markets. AOL Time Warner shares finished at $11.40, down 15 cents, or 1 percent, in New York Stock Exchange trading. In after-hours trading, shares fell as low as $10.49.

AOL stock is hovering at its lowest levels since October 1998. Shares are down about 76 percent since the merger was completed.

The company has moved to restore investor confidence in recent days. On the day Robert W. Pittman, under pressure, announced his resignation as chief operating officer last week, the company overhauled its corporate structure, making the online division a part of a unit that also includes Time Inc., Time Warner Cable and the AOL Time Warner Book Group.

The reorganization is a stunning turn of events for the Internet division, which acquired Time Warner about a year and a half ago in what was then considered a triumph of new media over old media. The online division now is being overseen by Don Logan, a longtime Time Warner hand.

He is part of a new team Parsons put in place to reinvigorate the company's growth. For the three-month period ended June 30, the New York company reported net income of $394 million (9 cents a share), compared with a net loss of $734 million (17 cents) in the same period a year ago. If, however, current accounting standards on goodwill were in effect in the year-earlier period, it would have shown not a loss but a gain of $592 million, or 13 cents a share. That would mean this year's results would be 33 percent lower.

Excluding one-time items, AOL Time Warner reported a per-share profit of 24 cents, flat compared with the year-earlier period. Those results were 2 cents more than analysts' expectations, a survey by investment research firm First Call/Thomson Financial showed.

Quarterly revenue rose 10 percent, to $10.58 billion, exceeding analysts' target of $10.02 billion.

The online division, however, continues to struggle. During the quarter, advertising and commerce revenue fell 42 percent. Wayne H. Pace, the chief financial officer, said the online division generated $412 million in ad and commerce revenue, of which $342 million came directly from ad revenue.

Pace said he is comfortable with the company's accounting and disclosure practices, but he said he wants AOL Time Warner to be "on the leading edge" of disclosures.

The SEC probe disclosed yesterday is not AOL's first. In May 2000, the SEC alleged that AOL violated securities laws by issuing inaccurate financial reports during 1994, 1995 and 1996 related to how AOL booked its marketing expenses. AOL denied any wrongdoing but paid a $3.5 million fine—then the biggest amount in history—and restated three years of earnings as part of an SEC settlement.

Now, the SEC is reviewing how AOL Time Warner booked revenue. The Post examined a number of the online division's advertising and commerce deals, focusing on several transactions that added up to $270 million. That represented a small portion of AOL's nearly $5 billion in ad and commerce revenue during the period reviewed, July 2000 through March 2002.

AOL Time Warner's chief executive said that all of the deals examined by The Post had been reviewed by AOL Time Warner's outside auditor, Ernst & Young LLP, which confirmed the company followed accounting rules in booking the deals. Parsons also said he plans to swear to the accuracy of the company's financial statements under a requirement being imposed on executives as of Aug. 14.

Parsons, however, said that adhering to generally accepted accounting principles "may not be enough" in today's climate, an apparent allusion to financial scandals unfolding across corporate America today. As a result, Parsons said, the company is working to simplify its structure and provide investors with additional information about its financial results.

Parsons faces investor unrest on several fronts: At least eight class-action lawsuits have been filed in the past five business days alleging that AOL Time Warner officials made false and misleading statements about the company's business and financial condition and how it generated advertising and commerce revenue as a result of unconventional transactions.

Now, in light of the SEC probe, analysts remain concerned about the company's prospects.

"The SEC inquiry is troublesome to me," said Jordan Rohan, an analyst at SoundView Technology Group in Old Greenwich, Conn. He said the inquiry could make it difficult for AOL Time Warner to conduct business and seek deals with other companies. For now, he said the company's prospects are "still murky."

THE DEAL MAKERS | *How AOL Hit Its Numbers*

A Rocky Road

America Online's stock price has declined steadily since the company announced its merger with Time Warner on Jan. 10, 2000. The slide came as the entire media industry was hit by a falloff in advertising. AOL Time Warner Inc. first hinted at troubles generating ad revenue in July 2001 but did not cut revenue forecasts until after the terrorist attacks on Sept. 11—nine months after the merger closed.

FILE PHOTO/ASSOCIATED PRESS

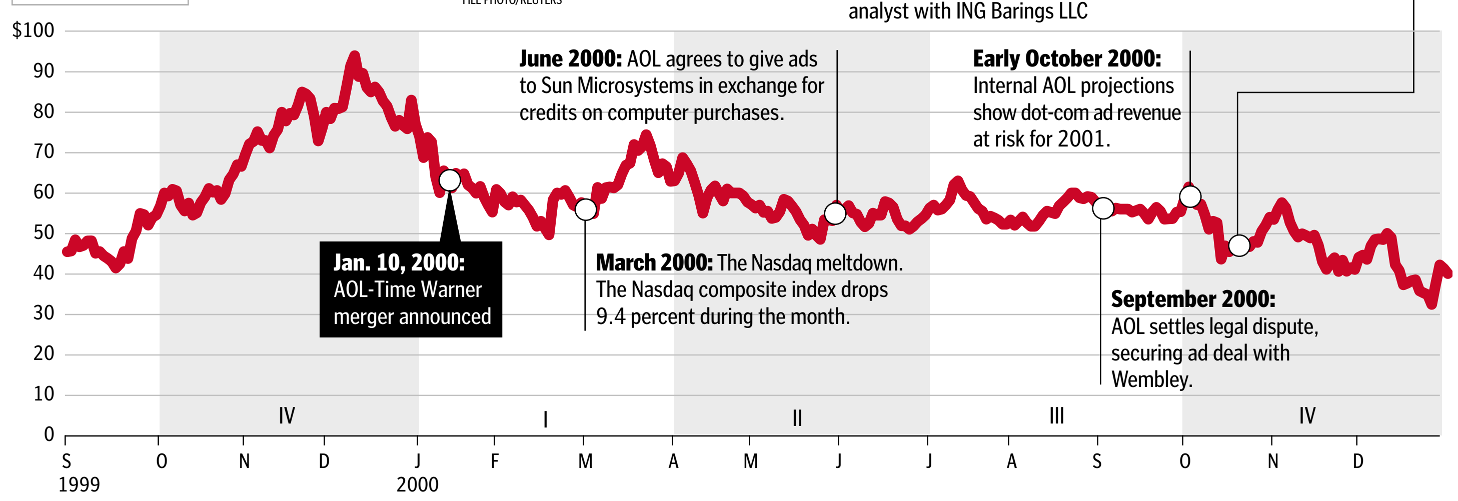
A growing America Online began moving into its huge Dulles campus in 1996.

FILE PHOTO/REUTERS

Stephen M. Case, left, and Gerald M. Levin celebrate the AOL-Time Warner merger announcement.

Oct. 18, 2000: AOL announces strong quarterly results. "AOL's advertising growth is right on target," says chairman and chief executive Stephen M. Case.

Oct. 19, 2000: "Solid advertising revenues attest to AOL's hybrid subscription/advertising model, which so far has provided the company with more protection from the dot-com meltdown than other large new media companies."—Youssef H. Squali, then an analyst with ING Barings LLC



SOURCES: Bloomberg News, Post research

AOL Sought to Sustain Growth Amid Slowdown

AOL, *From A1*

documents and interviews with current and former company officials and their business partners.

AOL converted legal disputes into ad deals. It negotiated a shift in revenue from one division to another, bolstering its online business. It sold ads on behalf of online auction giant eBay Inc., booking the sale of eBay's ads as AOL's own revenue. AOL bartered ads for computer equipment in a deal with Sun Microsystems Inc. AOL counted stock rights as ad and commerce revenue in a deal with a Las Vegas firm called PurchasePro.com Inc.

AOL also found ways to turn the dot-com collapse to its advantage, renegotiating long-term ad contracts it risked losing into short-term gains that boosted its quarterly revenue.

One AOL executive raised questions internally about some of the deals. Robert O'Connor, then vice president of finance for AOL's advertising division, said he outlined his concerns in a series of meetings last year and this year with Pittman, now in charge of the online division; David M. Colburn, who oversees its business affairs; J. Michael Kelly, chief operating officer of the online division; and other high-ranking company executives.

"Clearly, a lot of what they were living on was revenue that was not of the highest quality," said O'Connor, who resigned in March. "I don't know if they're still in denial, but there were some pretty big business issues they were not willing to face. For nine months, I tried to get these guys out of denial. I tried to take the perfume off the pig."

AOL said the deals were handled properly and the company "maintained a strict and effective system of internal controls." The company said the total revenue represented by all the deals reviewed by The Post was "truly microscopic"—less than 2 percent of AOL's overall revenue, including subscriber fees—and therefore immaterial to the company's business.

"The accounting for all of these transactions is appropriate and in accordance with generally accepted accounting principles," wrote Thomas D. Yannucci, a lawyer hired by AOL to respond to The Post's questions. "The disclosures in AOL's financial statements are appropriate and accurate. AOL's statements provide our investors with all appropriate material information about our business."

Further, he wrote, the company's outside auditor, Ernst & Young LLP, found the deals to be in accordance with generally accepted accounting principles. The auditor declined to discuss its review, citing the confidentiality of client matters, but H. Stephen Hurst, an Ernst partner, released a statement at AOL's request saying the firm stands by its original view that the accounting and disclosures were appropriate.

AOL officials declined to be interviewed on the record about the transactions.

The Post reviewed a number of AOL's advertising and commerce deals, focusing on several transactions that added up to $270 million. That represented a small portion of AOL's nearly $5 billion in ad and commerce revenue during the period reviewed, July 2000 through March 2002.

Without the unconventional deals, AOL would have fallen short of analysts' estimates of the company's growth in ad revenue (which is reported in a category that also includes revenue from commerce) in three quarters in 2000 and 2001.

Collectively, the deals helped AOL beat Wall Street analysts' expectations for earnings per share—a crucial profit yardstick for investors—by a penny per share in two quarters in 2000. At the time, investors punished companies whose earnings were off by even a cent. On the day AOL announced its earnings that October, Apple Computer Inc. said it missed Wall Street's reduced projections for its earnings by one cent, sending its shares down 6 percent a day later.

Revenue Targets

The driving force behind these deals was the powerful business affairs division within AOL, a hard-charging unit of 100 or so deal makers, including many lawyers, who helped negotiate and finalize most of AOL's largest transactions. Inside AOL, the unit was known simply as "BA" and some of its deals were called "BA specials," an allusion to the aggressive ways the division generated revenue.

Former and current AOL employees said company executives were partly motivated to meet revenue targets by the pending $112 billion all-stock acquisition of Time Warner. Even though this merger deal contained no dissolution clause that would be triggered if either partner's stock fell too far, company sources said that some AOL officials feared that if AOL stumbled, Time Warner shareholders could begin clamoring to end it anyway. Time Warner under some circumstances could have backed out of the deal by paying a breakup fee of about $4.4 billion.

"The bubble had clearly burst, but senior management was under enormous pressure to hit the [financial] numbers and close the Time Warner transaction, which would diversify the revenue base and lower the risk profile of the company," said James Patti, a senior manager in AOL's business affairs division at the time.

Patti said he told senior executives he was uncomfortable with some of the transactions pushed by his unit. Shortly after receiving a merit promotion, Patti was laid off in 2001, a move he said he believes was directly related to his refusal to participate.

"I had been asked to paper many of these questionable deals and was unwilling to cooperate, making my concerns known to management," Patti said. "The layoff came exactly one week later. Ultimately, I was happy to leave the company with my integrity and professional ethics intact."

AOL declined to comment on the departures of Patti and O'Connor. It disputes their characterization that it resorted to questionable deals to maintain strong ad revenue growth in the fall of 2000. In its written responses to The Post, AOL said its ad and commerce growth rate was healthy by any measure—80 percent higher during the quarter that ended Sept. 30 than a year earlier. It added that failing dot-coms accounted for only a fraction of its overall business and that other, more stable companies were more than making up that revenue.

The company said that Pittman and other executives were accurate in their public statements. During AOL's Oct. 18, 2000, conference call with analysts, Stephen M. Case, then AOL's chairman and chief executive, said, "AOL's advertising growth is right on target." He added: "The current advertising environment benefits us because it will drive a flight to quality." And Kelly, then chief financial officer, called AOL's ad and commerce revenue growth "very healthy" and emphasized, "I can't say that strongly enough."

Some experts who reviewed the deals examined by The Post questioned whether some of the deals were accounted for properly. They also questioned whether investors could have adequately understood AOL's advertising business from the company's statements and other information AOL made available to the public.

BY LES TODD—DUKE UNIVERSITY PHOTOGRAPHY

Duke University law professor James Cox says AOL should have been more forthcoming about the dot-com restructurings.

BY FRANK VERONSKY FOR THE WASHINGTON POST

Mary Meeker, a financial analyst for Morgan Stanley, wrote favorably of AOL's ad and commerce revenue results in the fall of 2000.

Adding It Up

Tally of deals reviewed by The Washington Post

IN MILLIONS OF DOLLARS

1	**Dot-coms** Revenue from deals that were terminated or restructured:	$56
2	**Wembley** Conversion of legal dispute into ad deal:	$23.8
3	**Ticketmaster** Conversion of legal action into ad deal:	$13
4	**Golf Channel** AOL negotiated a shift in revenue from Time Warner Cable to online unit:	$15
5	**EBay** Deal in which AOL booked revenue for selling eBay ads:	$95
6	**Sun Microsystems** Equipment-for-ads barter deal:	$37.5
7	**PurchasePro** Deals in which AOL booked performance warrants as ad and commerce revenue:	$28
8	**PurchasePro** Deal in which AOL bartered advertising:	$1.8

Total: $270.1 million

SOURCES: AOL, interviews, company records

THE WASHINGTON POST

AOL Says Accounting 'Was Appropriate'

AOL Time Warner Inc. yesterday issued the following statement from John Buckley, executive vice president for corporate communications for the online unit:

"The accounting for all of the transactions The Washington Post has discussed with AOL was appropriate and in accordance with GAAP [generally accepted accounting principles]. The disclosures in AOL's financial statements were also appropriate and accurate.

"AOL's independent auditors, Ernst & Young, specifically reviewed all but one of these transactions at the time they were accounted for. Moreover, since the Post contacted AOL, Ernst & Young has confirmed in writing that the accounting and related financial statement disclosure for all of the transactions were appropriate and in accordance with Generally Accepted Accounting Principles.

"Moreover, the facts show that AOL has maintained a strict and effective set of internal controls, a point underscored by the Post's own reporting.

"Finally, it should be noted that, in their entirety, the transactions cited by the Post comprised less than two percent of AOL's revenues during the same period, and accounting for them differently would have had no impact on the Company's net income."

"That's the whole purpose of financial statements—for investors and others to understand the business," said James Cox, a Duke University law professor who is a member of the legal advisory board of the New York Stock Exchange and the National Association of Securities Dealers.

Yannucci, AOL's outside attorney, wrote June 21 that no expert could render a proper judgment on the company's accounting without "a full understanding of the agreements and transactions at issue, as well as their context as part of AOL's overall business."

In a separate letter yesterday, Yannucci added: "We believe such arm-chair speculation about AOL's accounting and financial disclosures by less than fully-informed 'experts,' directly contradicted by the fully-informed views of our outside auditors (Ernst & Young), is not only grossly unfair and unwarranted in light of the exhaustive facts we have presented to you, but is also reckless in the current highly-charged environment."

When the company eventually identified a downward trend in its advertising business, it properly disclosed it in the latter part of 2001, Yannucci wrote.

Shares of AOL Time Warner Inc., as the company was renamed after the merger, have been in retreat ever since, closing at $13.11 yesterday, down 72 percent since the deal was consummated.

Wall Street has begun to question whether the AOL-Time Warner marriage ever made sense—for Time Warner—in light of the online unit's weakness. The company still possesses an array of powerful assets, such as HBO, Warner Bros. and Time magazine (a competitor of Newsweek, which is owned by The Washington Post Co.). But now, company officials are struggling to turn around the online unit.

Birth of a Giant

The evolution of AOL from a small online service to a major advertising force began in late 1996.

Facing stiff price competition from other Internet service providers, AOL abandoned the hourly fee that it had been charging customers, replacing it with a flat-rate monthly charge. Users began to spend more time online, taxing AOL's network and eating into its profit margin. AOL set its sights on getting companies to buy ads to promote themselves on its vast online network.

Ad revenue was intended to keep the company growing at a fast clip after the growth of its basic business—monthly subscriber fees—began to ebb.

"Advertising was supposed to be the big thing to defray concerns about AOL plateauing," said Michael Bromley, a business development director for AOL consumer devices until he was laid off last year. "On Wall Street, it's not what you make, it's what you're perceived as."

By the fall of 2000, ad and commerce revenue had rocketed from virtually nothing to more than $2 billion a year—about a third of the company's overall revenue. A prime reason was the emergence of dot-coms initially rich with venture capital and eager to promote themselves.

But the capital now was drying up and the Nasdaq Stock Market was in a free fall. Questions about ad revenue began to emerge on Wall Street just as AOL sought to complete its Time Warner merger.

Several analysts at the time took AOL's reports of a big jump in ad and commerce revenue in the Sept. 30 quarter as a sign of the company's strength in the face of a slowing ad market, and they encouraged investors to buy AOL shares as the merger neared.

In a research note a day after AOL's Oct. 18 conference call, analyst Youssef H. Squali, then of ING Barings LLC, reiterated his "strong buy" rating on AOL's stock. "Solid advertising revenues attest to AOL's hybrid subscription/advertising model, which so far has provided the company with more protection from the dotcom meltdown than other large new media companies," he wrote.

Mary Meeker, an analyst at Morgan Stanley Dean Witter & Co., was also encouraged by AOL's ad and commerce revenue results. "This has developed quickly into AOL's fastest growing revenue stream and a key element of growth going forward," she wrote in a research note a day after AOL released its numbers.

And analyst Christopher Dixon, then of PaineWebber Inc., wrote that AOL's strong ad and commerce revenue "should alleviate some concerns about the health of the Internet advertising environment."

What the analysts failed to note—or didn't know—was that many dot-coms no longer had the cash to pay for all the ads they had agreed to buy in their premium-priced long-term contracts with AOL.

At the company's Dulles offices, AOL was already holding weekly emergency meetings to discuss the status of failing dot-com ad deals, company sources said. AOL closely monitored the status of these ad deals, large and small, according to several company documents obtained by The Post.

The AOL documents gave a detailed report, week by week, of the health of the dot-coms, how much they owed AOL, what AOL was doing to get its money, how the dot-coms were responding and how much money AOL reckoned it could lose if the dot-coms didn't pay their bills.

One firm, Living.com, an online furniture business, owed AOL $1.2 million. "They are out of $, wanted to look at new deal but then backed out completely," AOL stated in a confidential summary of dozens of deal restructurings, dated Aug. 18.

AOL's conclusion: "Not solvable."

The company was right: Living.com shut down that month.

In another internal document, AOL stated that BigEdge.com, an online sporting goods retailer, "Demanded restructuring conversation with 3 options (including terminating deal outright)."

AOL figured its upcoming payment of $500,000 "may be in jeopardy."

BigEdge.com was a part of MVP.com, another struggling firm whose domain name, trademark and certain assets were sold off to SportsLine.com in January 2001.

There were dozens of other shaky deals of various sizes. They added up. AOL faced the risk of losing $23.2 million in revenue in the quarter ended Sept. 30, 2000, according to an internal company memo summarizing the situation.

Early Warnings

In September, other internal company documents obtained by The Post said that AOL was "at risk" to lose more than $108 million in ad revenue in fiscal 2001, from July 2000 to June 2001, with most of that jeopardized revenue coming from dot-coms. In early October, O'Connor, the AOL advertising executive, said he briefed Pittman and other company executives about the weakness of AOL's dot-com advertisers two weeks before Pittman's October 2000 comments. O'Connor said he told them that the company risked losing more than $140 million in ad revenue in calendar year 2001.

AOL said that just because ad revenue was identified as "at risk" did not necessarily mean the company would fail to collect it. Yannucci, AOL's attorney, did not respond to The Post's question about how much dot-com revenue was lost in that period. He wrote that "one would hope" O'Connor's estimate was "a worst-case assessment."

Cox, the Duke professor, said he believed that AOL should have been more forthcoming about the dot-com restructurings. It appears that a significant part of AOL's ad business was in jeopardy and it should have said so publicly, Cox said. "They have an obligation to disclose what is happening to the present client base," he said.

AOL said it had no obligation to make such disclosures, asserting the amounts were too small. "It should be beyond reasonable dispute that these amounts do not remotely represent a material percentage of AOL's advertising and commerce revenues for these quarters," AOL's attorney wrote.

But Doug Carmichael, a professor of accounting and director of the Center for Integrity in Financial Reporting at the City University of New York's Baruch College, disagreed. In accordance with Securities and Exchange Commission requirements, he said, AOL should have disclosed "significant negative trends" that company officials knew about. "And certainly," Carmichael

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THE DEAL MAKERS | *AOL's Warrior Culture*

Business Division Leader Demanded Loyalty

AOL, *From A1*

generate revenue, a reference some attendees took for the aggressive way the company constructed the transaction.

Colburn himself and several other attendees do not recall the statement, according to an attorney AOL hired to respond to The Post. The company declined to make Colburn or any other member of the business affairs unit available for comment.

Under terms of the agreement, AOL would sell software for PurchasePro and, in exchange, earn tens of millions of dollars in performance warrants—a right to buy PurchasePro stock at a certain price. AOL would book the value of those warrants as advertising and commerce revenue. It was an unconventional arrangement, but one that AOL's attorney said did not violate any accounting rules.

Wakeford and Witt joined Colburn on stage and accepted the plaque. In his acceptance speech, Wakeford thanked someone who was not in attendance: "Junior," Charles E. Johnson Jr., PurchasePro's rambunctious founder and then-chief executive.

The crowd roared with laughter over the tongue-in-cheek remarks. But not everyone was amused.

"The sheer arrogance, the feeling of being untouchable, was amazing," said one attendee.

AOL's business affairs culture rewarded those who could be creative—and those who knew how to close deals. Business affairs executives usually got involved in advertising transactions after the sales force had reached a general agreement with clients. Business affairs would draw up a list of proposed terms and talk to the company's accountants about how to structure the deal.

The unit's work was blessed by executives at the highest levels. Business affairs deal makers answered to Colburn, who reported to Robert W. Pittman, then AOL's president. Their deals also were reviewed by AOL's auditors, and were subject to what AOL said was a "strict and effective system of internal controls."

Sources said those controls were necessary to deal with a unit like business affairs, whose complex transactions were known as "BA specials" inside AOL. Typically, the unorthodox deals involved contracts that closed late in a fiscal quarter and helped AOL boost its financial results.

Though its deal makers may have been aggressive, AOL said they generally had little idea whether their efforts would produce favorable quarterly results. The company said too many deals were up in the air in the closing days of a quarter for anyone to be sure how the final tallies would turn out.

Pressure to close ad deals was particularly intense during much of 2000, when the company sought to complete its merger with Time Warner, the sources said.

"It was definitely part of everyday life. It was definitely out there," said Jonathan Salkoff, who served as a manager in business affairs and declined to discuss specific company matters. He was laid off in January 2001, just after the merger was approved.

After completing the Time Warner takeover, AOL sources said they continued to feel pressure to close deals. It was, they said, part of business affair's culture—an unrelenting need to win.

The Good Times

When AOL announced its blockbuster takeover of Time Warner in January 2000, business affairs was at full throttle.

Start-ups lined up to strike a deal with AOL, a blue-chip Internet firm in a sea of untested wannabes searching for an IPO, the initial public offerings of stock that had already created mind-boggling personal wealth for many denizens of Silicon Valley.

The transactions, in turn, helped enrich AOL. Everyone, it seemed, was becoming an instant millionaire at the company's Dulles headquarters. There were a lot of Ferraris. And twentysomethings and secretaries retiring with seven-figure bank accounts after a few years on the job, thanks to the incredible windfall from stock options.

At business affairs, almost anything seemed possible. Hard work begot wealth. Wealth begot parties. And parties, AOL sources said, became part of work.

That included a spontaneous excursion from Dulles to San Francisco by a handful of AOL officials on the corporate jet. They called it a "team-building trip."

It took place in the Gold Club topless bar on Howard Street, said sources who were present, and both men and women from AOL attended.

"The lavish parties, the crazy antics—it really socialized you," said another AOL source. "You had to toe the line."

The Heart of a Deal

Here is how America Online brings advertising deals to fruition, a process that takes anywhere from one to six months:

1. The **interactive marketing division** typically makes the initial contact. Usually, it's a manager, director or vice president who makes the call, depending on the size of the deal. The **carriage plan**—the number of online impressions, ad placement and estimated cost—is discussed in general terms.

2. Once a general agreement is reached, **business affairs** takes over. A manager, senior manager or director will go over the deal's economics and draw up a **term sheet**, a basic ad agreement. The term sheet goes to AOL's **legal team**, which turns it into a formal contract.

3. When an agreement has been reached on the contract, business affairs distributes it for formal **sign-offs** by other affected AOL divisions, such as **accounting**, **legal** and **ad operations**. Sign-offs are usually done by e-mail, but the bigger the deal, the more likely that sign-offs will be done in person, with an e-mail follow-up.

4. Then the business affairs lead official takes the contract in person to **David M. Colburn**, head of business affairs. The official walks Colburn through the contract; if Colburn approves, he gives a verbal acceptance and then signs the contract.

5. **Ernst & Young**, **AOL's outside auditor,** periodically reviews deals—often at the prompting of AOL's internal accountants—and also examines them at the end of the quarter.

SOURCE: Staff reports

THE WASHINGTON POST

AOL declined to comment on such conduct, other than to say it does not condone activities that would be in violation of company policies.

Colburn's Charge

The tone for the company's culture back in the heyday of 2000 was set by Colburn, then head of business affairs.

Colburn, now executive vice president and president of business affairs and development for AOL Time Warner's subscription services and its advertising and commerce businesses, was a larger-than-life figure.

A lawyer, former venture capitalist and former chief executive of a poster company, Colburn is athletic but carries a paunch. He is charismatic and rough-hewn. Tall and imposing, he speaks in a high-pitched, nasal tone.

By many accounts, Colburn also commanded respect as a brilliant corporate strategist, a smart lawyer who remembered every detail and was always thinking 10 steps ahead in every negotiation.

He burnished his imposing reputation on Sundays at 9 a.m. on the regulation basketball court outside his large, clapboard and stone country-style house in Potomac.

There, he gathered his loyalists—a group of deal makers who wanted to move up the corporate ladder. Attendance was de rigueur. What he taught his disciples was his way of playing sports—and doing business. He played a ferocious game, breaking down his opponents with rough elbows, blatant fouls and name-calling, attendees said.

"It's the way he gets people to love him and fear him," said an AOL official. "You don't go to play, you go there to be abused."

Colburn could be rougher on his troops at work, said several sources, many of whom declined to speak for attribution for fear it would hurt their career or jeopardize their benefits.

Once, Colburn beckoned Ted Rogers, then a new member of his team—and a former Washington Redskins player—and gave him a dressing down outside AOL's fifth-floor boardroom during a meeting of "Op Com," the operating committee of senior executives, chaired by Pittman.

Witnesses said Colburn screamed at Rogers for a paperwork mistake—getting the wrong AOL executive's signature on a particular deal. The berating became water-cooler legend: If Colburn could decimate Rogers, a 250-pound, 6-foot-2½ former linebacker, what about the rest of his crew?

When asked about the incident, Rogers said, "Maybe I deserved it. I don't know. I felt completely demoralized because it was my first deal."

Rogers said he realized that the company's "lifestyle and culture" wasn't for him, so after 14 months he left AOL of his own accord in May 2000.

Every couple of weeks, AOL sources said, Colburn would pick other people, poke fun at them, yell at them, break them apart, then build them back up.

"He'd put an arm around you, and say, 'Things are going to be all right, I really love you,' " said an AOL source. "He'd say a kind word, and it'd make your day. It's like an abusive father."

Colburn also bestowed financial rewards on his minions. He would send favored underlings and their spouses on weekend getaways to places like New York, all expenses paid, including limousine service and lavish dinners, AOL sources said.

Colburn helped decide who got stock options, another powerful incentive to keep employees in line, especially when AOL shares were on the rise, sources said. During the height of the Internet boom, employees recalled logging on to their computers in the morning, checking their portfolio and staring in amazement at their growing assets.

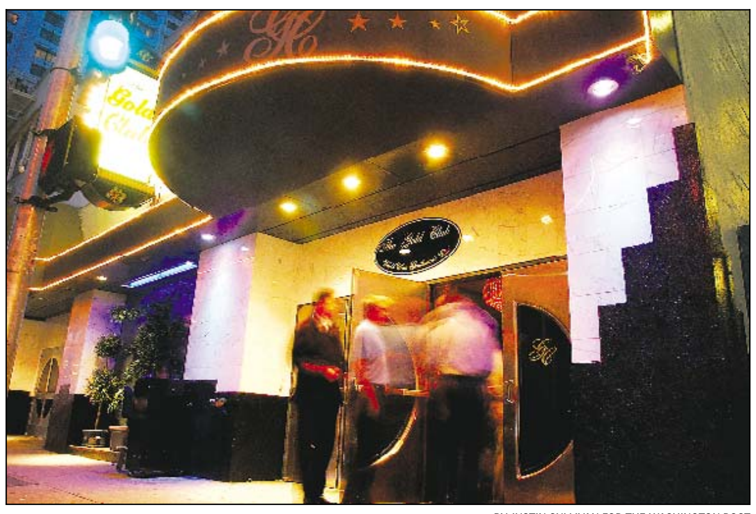
"It was like, 'Wow, I just made a few thousand dollars just by sleeping,' " said an AOL official.

COURTESY CHAI LIFELINE

David M. Colburn, known as a brilliant corporate strategist, set the tone for AOL's culture as head of its business affairs division.

COURTESY CHAI LIFELINE

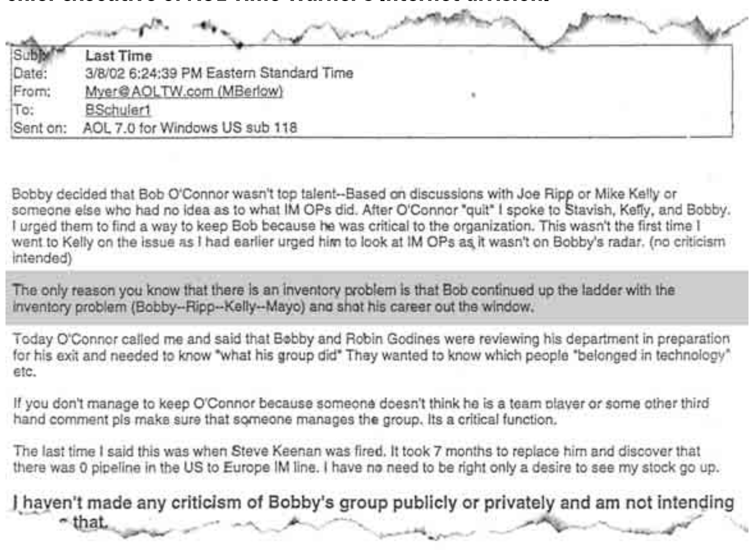
Myer Berlow, Colburn's counterpart at AOL's interactive marketing division. The two were sometimes known to yell at their deal makers.



BY JUSTIN SULLIVAN FOR THE WASHINGTON POST

AOL "team-building" trips included one to San Francisco's Gold Club topless bar, according to sources. Both men and women from AOL attended.

Robert O'Connor, vice president for finance in AOL's advertising division, resigned after he raised concerns about the company's ad inventory and was told he wasn't a team player. In an e-mail (an excerpt of which is shown below), Myer Berlow, then president of global marketing solutions, referred to O'Connor's outspokenness in a note to Barry Schuler, then chairman and chief executive of AOL Time Warner's Internet division.



Subj: Last Time
Date: 3/8/02 6:24:39 PM Eastern Standard Time
From: Myer@AOLTW.com (MBerlow)
To: BSchuler1
Sent on: AOL 7.0 for Windows US sub 118

Bobby decided that Bob O'Connor wasn't top talent--Based on discussions with Joe Ripp or Mike Kelly or someone else who had no idea as to what IM OPs did. After O'Connor "quit" I spoke to Stavish, Kelly, and Bobby. I urged them to find a way to keep Bob because he was critical to the organization. This wasn't the first time I went to Kelly on the issue as I had earlier urged him to look at IM OPs as it wasn't on Bobby's radar. (no criticism intended)

The only reason you know that there is an inventory problem is that Bob continued up the ladder with the inventory problem (Bobby--Ripp--Kelly--Mayo) and shot his career out the window.

Today O'Connor called me and said that Bobby and Robin Godines were reviewing his department in preparation for his exit and needed to know "what his group did" They wanted to know which people "belonged in technology" etc.

If you don't manage to keep O'Connor because someone doesn't think he is a team player or some other third hand comment pls make sure that someone manages the group. Its a critical function.

The last time I said this was when Steve Keenan was fired. It took 7 months to replace him and discover that there was 0 pipeline in the US to Europe IM line. I have no need to be right only a desire to see my stock go up.

I haven't made any criticism of Bobby's group publicly or privately and am not intending that.

THE WASHINGTON POST

But in exchange for such largess, Colburn demanded loyalty, AOL sources said, and never was that more clear than when AOL was at the pinnacle of its power.

"He created these foot soldiers who went to war for him," said an AOL source. "These were heady times."

Picking Partners

AOL could make or break a company just by picking which one it decided to do business with. When AOL struck a deal with a dot-com, it often had the effect of giving the start-up instant credibility, a leg up on the competition and better prospects for launching an IPO.

"I would basically pick the winner of [an industry], their stock would go up, and they'd be instantly rich, and they'd do anything for me," said an AOL business official.

Just as Colburn exacted loyalty from his employees, AOL exacted steep terms from its partners. Sometimes, in a display of its clout, AOL would demand that a dot-com sign an ad deal within 24 hours or AOL would take the offer elsewhere, company sources said.

During the Internet bubble, AOL deal makers had another advantage: Frequently, they were bargaining with naive dot-commers in their twenties and thirties who had never negotiated a business deal in their lives.

AOL said its executives did not mistreat prospective clients. The company said it was common for its deal makers to seek out relationships with new business partners, and then leverage those relationships to generate additional revenue.

There was a perception within AOL that some business affairs executives acted as though there were no rules. AOL sources described a deal in which a junior financial analyst at the company had been directed by a BA official to alter an internal report steering more revenue to Homestore Inc., an online home and real estate service, sources said.

Homestore shared revenue with AOL from advertising sold on Homestore's house and garden areas within AOL's online network, the sources said.

Every month, AOL financial analysts would receive a report from operations, showing the level of ad revenue and an estimate of Homestore's share. Without explaining why, business affairs told the AOL financial analyst to change the report, inflating Homestore's ad revenue share by an additional $2 million, the sources said.

When AOL officials discovered the problem, the maneuver was short-circuited, and the company said it fixed the error. "[W]hile a report which erroneously attributed a revenue share from certain advertisers to Homestore was initially generated, the mistake was identified and the report was later corrected," AOL's attorney said in a letter to The Post.

AOL said that outcome demonstrated the effectiveness of its internal controls. Homestore officials declined to comment.

Grim Times

By August 2000, the business affairs bravado was beginning to deflate.

The tech-laden Nasdaq Stock Market was hemorrhaging, dot-coms were dropping like flies and grim senior deal makers at AOL convened emergency meetings around a long conference table in the boardroom, sandwiched between the offices of Stephen M. Case, then AOL's chairman and chief executive, and Pittman, then AOL's president.

Before them was a growing list of struggling start-ups pleading to restructure their advertising deals.

Colburn ran the meetings. Myer Berlow, his counterpart heading the interactive marketing division, which worked with business affairs on ad deals, would sit in or monitor the proceedings by speakerphone. Participants said many discussions were more like yelling matches. Colburn and Berlow would sometimes scream at their deal makers about the need to get AOL's business partners to pay up.

"Why can't you get this deal closed?" Colburn would shout, recalled someone in attendance. "Why can't you do this?"

The deal makers would throw up their arms in futility.

"Colburn was always reminding everybody what pressure we were in because of the merger," said an AOL official. "He'd say, 'Are you guys crazy? Are you forgetting what we have to accomplish?' "

The Telefonica Deal

The pressure inside AOL tightened like a vise: The stock was eroding, and the firm was engaged in tedious negotiations with federal regulators reviewing the merger. Enough failing dot-com advertisers could compound the problems.

For months, AOL managed to keep up its ad revenue from dot-coms by restructuring their deals into shorter-term arrangements. But by mid-December 2000, it became harder to find revenue. In at least one instance, business affairs pushed too far.

The unit brokered a deal to sell $15 million in online ads to Telefonica SA, the big Spanish telecommunications company. AOL needed to run the ads in the final days of December to book the revenue in that quarter.

But with so little time left, AOL had to place the ads in high-traffic areas of AOL, such as its welcome screen, the first Web page people see when they use the service. More consumers saw ads on the welcome screen and AOL could get faster credit for running the promotions.

AOL officials didn't care that the Telefonica link from AOL's English-language welcome screen took users to a Spanish-language site, said AOL sources familiar with the deal. Nor did it matter that Telefonica's computer servers couldn't handle all of the customer traffic from AOL, they said.

AOL succeeded in running the Telefonica ads fast to book the revenue before Dec. 31, as accounting rules required.

But after the deal was done, and January came along, AOL was still running the Telefonica ads. Under the deal, they were supposed to have stopped in December.

When some AOL officials noticed the ads were still running, they raised questions and learned it was happening at the behest of business affairs. The unit's officials had struck a verbal agreement with Telefonica to continue running hundreds of millions of ad impressions for months beyond December, as a bonus, the sources said.

The bonus, it turned out, was a key condition for Telefonica agreeing to spend $15 million on ads that would run in the December quarter, the sources said. Without the bonus, Telefonica would have insisted on running the $15 million in ads over several quarters, which would have forced AOL to book a smaller amount of revenue in the December period, the sources said.

In the end, AOL's internal accountant determined that the $15 million December ad deal was really part of a longer-term commitment, which included the ads that had run as part of the bonus deal, sources said. As a result, internal accountants moved about $5 million of the Telefonica revenue from AOL's December quarter to the next quarter.

AOL said the firm's action "highlights the rigor and integrity of AOL's internal accounting controls."

Telefonica declined to comment on the specific transaction, but in a statement it said, "Our relationship with AOL covers several areas and we at Telefonica are satisfied with all aspects of this relationship."

Elusive Targets

After the merger, the ad market continued to weaken in 2001, forcing down online ad rates. Robert O'Connor, then vice president of finance for AOL's advertising division, said he warned company executives last year and this year that the trend would eventually create a fundamental business problem.

As the price of online ads fell, AOL would be forced to sell more ads to reach its revenue targets, O'Connor told other company officials. There was a finite number of Web pages that AOL's users viewed in a given period. Eventually, AOL would run out of online space—inventory—to run ads where consumers would see them.

As it was, AOL was racing to run all the ads it was selling. In some cases, AOL resorted to what was known internally as "jackpotting." The term referred to gambling slot machines, where, for example, three cherries in a row wins.

In AOL's case, jackpotting meant it would run the same ad three times on a single Web page, often at the bottom of the screen, where it was less visible, sources said.

AOL also took advantage of its "ad rotation" to run more ads, sources said. When viewers look at a screen, the Web page automatically refreshes itself at a specific interval, sometimes from eight to 10 seconds.

But at the end of a quarter, when AOL was trying to meet its financial targets, it would increase the speed of the ad rotation to get credit for running more ads, sources said.

In late February this year, AOL executives informed O'Connor, who continued to raise questions about inventory, that he was not a team player and that he no longer had a bright future at the company, according to a company e-mail. O'Connor immediately said he would resign. AOL would not comment on O'Connor or his departure.

Berlow, later named president of global marketing solutions for the parent company, tried to persuade AOL officials to stop O'Connor from leaving. In a March 8 e-mail to Barry Schuler, then chairman and chief executive of the Internet division, Berlow defended O'Connor.

"The only reason you know that there is an inventory problem is that Bob [O'Connor] continued up the ladder with the inventory problem (Bobby-Ripp-Kelly-Mayo) and shot his career out the window," Berlow wrote to Schuler.

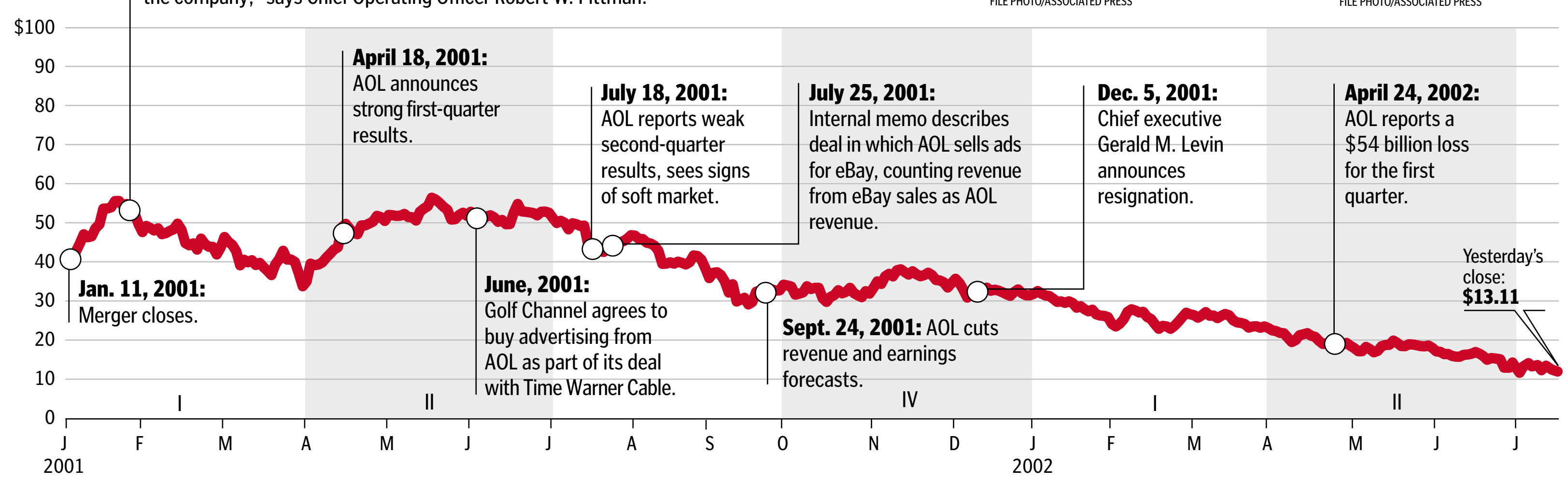
Berlow was referring to Robert Friedman, then head of AOL's interactive marketing division; Joseph A. Ripp, chief financial officer of the Internet unit; J. Michael Kelly, the chief operating officer; and Mayo Stuntz Jr., executive vice president of AOL Time Warner's cross-divisional initiatives.

O'Connor left the company on March 29 without negotiating a severance package. He said he was no longer comfortable working in an environment where officials didn't want to hear about internal business issues.

"Not only were they not willing to get out of denial," he said, "now they were going to actually punish those who were going to even raise issues."

Staff researcher Richard Drezen contributed to this report.

THE DEAL MAKERS | *How AOL Hit Its Numbers*

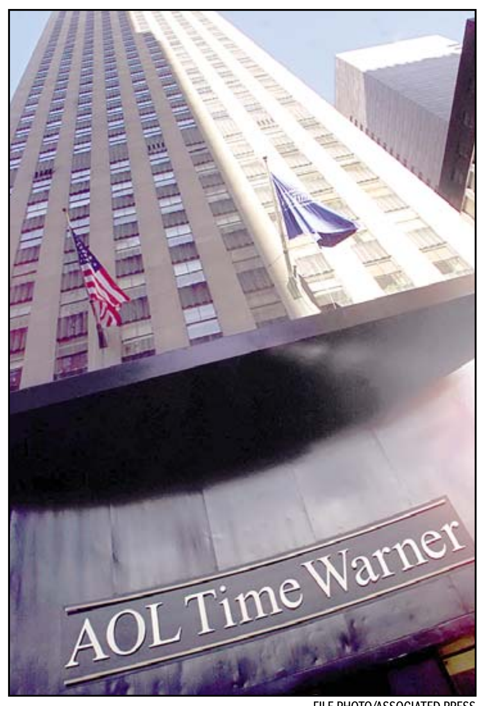


Chief Operating Officer Robert W. Pittman was still optimistic in early 2001.

FILE PHOTO/ASSOCIATED PRESS

Gerald M. Levin greets shareholders outside the Apollo Theatre before AOL Time Warner's May 2002 annual meeting, where he formally handed the reins to Richard D. Parsons.

FILE PHOTO/ASSOCIATED PRESS



The merged company's new headquarters—the AOL Time Warner Building in New York.

FILE PHOTO/ASSOCIATED PRESS

THE WASHINGTON POST

said, "the problems with dot-coms were material to them."

AOL sources who were familiar with these dot-com deals said the company considered taking the struggling firms to court to get them to pay for the ads that they had agreed to buy. But the sources said AOL determined that such a strategy wouldn't be fruitful because the public filings would show some weakness in its business.

So AOL advertising officials went to work. They strove to convert some of the risk to AOL's long-term ad contracts into a short-term gain, by getting one-time payments from clients who could no longer meet their obligations. That helped put off the day when the dot-com advertising swoon would be apparent in the company's quarterly results.

In some instances, AOL said in its written response to The Post, it would renegotiate a struggling dot-com's ad deal to shorten the term of the contract. The dot-com would pay AOL a fee for breaking the deal early, and that fee would be incorporated into the new, shorter-term ad deal, effectively creating a balloon payment. AOL would count all of the revenue, including the fee for renegotiating a shorter-term deal, as ad revenue.

AOL said it accounted for the deals properly. Amounts "earned by AOL under these types of long-term advertising agreements have always been advertising revenues and the restructurings do not change the character of those revenues, only the time frame over which they are measured and the amount that should be recognized," wrote Yannucci, AOL's attorney, in a letter to The Post.

From July 2000 through March 2001, AOL said, it booked $56 million from dot-com deals that were terminated or restructured, about 3 percent of its $2.1 billion in overall ad and commerce revenue during that time. In each quarterly earnings report during the period, the terminated and restructured deals ranged from 1.5 to 4.4 percent of AOL's advertising and commerce revenue.

Eventually, as the pattern of restructuring dot-com contracts repeated itself quarter after quarter, AOL reported the trend in the latter part of 2001. In its Nov. 14 SEC filing it said: "The growth in advertising and commerce revenues was driven by a general increase in advertising sales, including amounts earned in connection with the settlement of certain advertising contracts."

By the December quarter that year, online advertising had swung from growth to contraction, decreasing by 7 percent over the same period a year earlier.

24dogs.com

In September 2000, AOL found another way to boost ad sales: from a legal dispute.

The origins of the legal case reach back to 1992, far removed from AOL, when MovieFone Inc., an online ticketing firm, and a former subsidiary of Wembley PLC, a big British entertainment company, set up a joint venture to develop hardware and services for automated movie-ticketing sales, according to U.S. legal filings and British public documents. The parties had a falling-out, the matter went to arbitration, and three years later MovieFone won an award against the former Wembley subsidiary.

When AOL purchased MovieFone a year later in 1999, it inherited the $22.8 million arbitration award, plus interest, which had not yet been paid.

AOL said it would have been costly to litigate with an overseas company. So AOL in September 2000 offered an alternative: Buy $23.8 million in online ads instead. That would also save the British firm money—requiring Wembley to spend $3 million less than the arbitration award, including interest, according to sources familiar with the negotiations and confidential company documents summarizing the deal.

But AOL had to move fast, the sources said. The company was short of its targeted advertising and commerce revenue for the Sept. 30, 2000, quarter ending just days away.

The British wondered what they had to advertise to AOL's users. Wembley was in the gambling business, operating greyhound race tracks in such places as Rhode Island and Colorado.

AOL's answer: 24dogs.com.

Wembley was preparing to launch 24dogs.com, an online greyhound-racing Web site. Still under construction, the Web site would allow gamblers to check the odds and place a bet on a dog.

AOL suggested it could run ads for the Web site. The British mulled the offer. But with the quarter closing fast, AOL could not afford to wait.

To book the revenue in the quarter, AOL needed to run the ads before Sept. 30 to conform with accounting rules. So, without Wembley's knowledge, AOL employees lifted art work—a picture of a racing greyhound—off the British company's 24dogs.com Web site, created banner and button ads out of it and started running them, said AOL sources familiar with the matter.

The greyhound banner and button ads ran on various AOL sites, including Spinner.com, its online radio service, the sources said. AOL ran as many as three or four Wembley ads on a single Web page.

The number of greyhound ads, however, got to be a little too much, even for some at AOL, the sources said. A Spinner official on the West Coast called an AOL official in Dulles, and complained, "Dude, my home page looks like a dog site," according to a source familiar with the conversation.

Within about an hour of posting the greyhound ads, Wembley's unfinished Web site crashed from an overload of customer traffic from AOL, sources said.

AOL got its deal. Wembley agreed to buy $23.8 million in AOL ads. The terms of the deal allowed AOL to dictate—at its own "discretion"—when and where the Wembley ads would run through AOL's vast network. Such a provision meant that Wembley's ads could have appeared at any time or place—not necessarily targeting its core audience.

Wembley confirmed that it reached a confidential agreement with AOL but declined to discuss any of the specifics.

According to a copy of the Sept. 26, 2000, confidential settlement between the companies, AOL and Wembley released each other from all claims. It stipulated that "AOL will promote various Wembley USA websites with 1 billion [ad] impressions to run at AOL's discretion. Such promotion is: a) a good faith gesture by AOL to expeditiously and amicably settle the arbitration matter, and b) a way to demonstrate the potential of AOL's interactive properties to drive traffic to Wembley USA websites."

AOL ran enough ads to book $16.4 million in that quarter. In the same three-month period ended Sept. 30, 2000, AOL converted another unresolved legal action into ad revenue, a $13 million deal with Ticketmaster, a majority-owned unit of USA Interactive Inc., according to internal company documents and sources.

Ticketmaster declined to comment.

Several accounting experts took issue with the Wembley deal, saying money from an arbitration award owed to a company that AOL acquired should have been booked as something other than ad revenue.

"To say that was $23.8 million in ad revenue, I have to question that," said Walter P. Schuetze, the chief accountant at the SEC from 1992 to 1995 and the chief accountant of its enforcement division from 1997 to 2000. "That's pulling white rabbits out of black hats."

AOL said it booked the Wembley and Ticketmaster deals appropriately. "It is entirely common and appropriate to resolve litigation by creating or amending a business relationship—even if that litigation has reached the point of a judgment," said AOL's attorney. ". . . Such resolutions are one way in which unproductive disputes are turned into productive, and hopefully continuing, business relationships."

After AOL and Wembley signed the ad deal, sources said a handful of business affairs officials gathered in a vice president's office at AOL and celebrated by blaring a popular song on a personal computer: "Who Let the Dogs Out."

After the Merger

When AOL closed its merger with Time Warner on Jan. 11, 2001, it quickly began touting the combined company's synergies, or its ability to generate growth in all areas of the business by cross-promoting properties and leveraging deals made by one unit across others.

One example involved a deal between AOL's Time Warner Cable division and the Golf Channel, a majority-owned unit of cable giant Comcast Corp.

According to sources familiar with the deal, the Golf Channel agreed in June 2001 to pay $200 million over five years to have its sports programming carried on Time Warner Cable, the nation's second-largest cable television provider. But once the deal was essentially in place, the online unit weighed in, asking Time Warner Cable to share a piece of the Golf Channel deal, the sources said.

Complying, Time Warner Cable told the Golf Channel to spend about $15 million of the $200 million transaction for advertising on AOL's online unit, according to sources.

Cable companies often use such negotiations to extract concessions out of programmers. AOL sources said the Golf Channel had few options—if it wanted to be carried on Time Warner Cable. "We told them where and when" the ads ran, said a source familiar with the deal. "They didn't have a choice."

Golf Channel spokesman Dan Higgins confirmed his company agreed to buy the online ads because it wanted the cable deal.

"When you're trying to negotiate long-term deals with them [cable companies], there are certain things that matter to them," said Higgins, who would not discuss details of the negotiations. "If they want the money to go to certain places, as long as it's in line for us . . . you come to a deal that both can live with." He called the agreement "mutually beneficial."

Higgins said that while AOL stipulated that the Golf Channel buy online ads as part of the cable agreement, it benefited the Golf Channel. "AOL reaches a lot of people," he said. "From a branding perspective, it's good for us."

The $15 million ad deal also helped AOL's online division report better numbers in its third quarter, ended Sept. 30, 2001.

Yannucci, AOL's attorney, wrote that "it was perfectly sensible to advertise the Golf Channel on AOL."

Enter EBay

On July 25, 2001, AOL found another way to generate ad dollars, this time through an agreement with eBay, the giant online auction site.

AOL was not only an advertising medium for other companies, it also served as an advertising broker, selling ads for other companies that lacked AOL's expertise and sales force. AOL agreed to serve in this capacity for eBay, hoping to sell a big chunk of the auction site's ad space, according to AOL's confidential executive summary of the deal. AOL said it was able to bundle advertising for different Web sites and offer package deals to advertisers.

In the eBay deal, AOL did not simply take the customary commission of an ad rep. AOL counted all of the eBay revenue as if it were AOL's own.

"AOL recognizes all revenue generated from eBay inventory sales on a topline basis," AOL said in its internal documents.

When asked about the financial arrangement, AOL declined to make any documents available but confirmed that it booked the sale of eBay's ads as AOL's own revenue, which it maintained is the proper accounting method. AOL said it booked $80 million in revenue in 2000 and 2001 and $15 million in the first quarter of 2002, the gross amounts from selling eBay's ads.

With this accounting, AOL was able to report a larger amount of ad and commerce revenue. (The gross sales didn't change AOL's net income, because AOL counted the payments it forwarded to eBay—minus its broker's fee—as an expense elsewhere in its books.)

Under accounting standards, there are several factors to consider in determining which party can book the gross revenue from a transaction.

One way an agent can book the gross amount of revenue from the sale of a merchant's goods is if the agent first acquires the goods and then resells them to another party, accounting experts said.

Such is the case with Priceline.com Inc., for example, which buys airline tickets from the airlines before reselling them to customers. But AOL did not buy eBay's advertising inventory.

AOL said it was appropriate for it to book eBay's revenue as AOL's own in part because the advertiser contracted directly with AOL, AOL set the price and received payment directly from the advertiser. AOL said eBay's accounting for the deal—booking only the net payments—shows that the company also viewed AOL as a principal.

Several accounting experts, however, said that those factors may not be sufficient for AOL to properly book eBay's ad sales as AOL's own ad revenue. They said the appropriate accounting largely hinged on the amount of financial risk AOL assumed in the transaction.

An internal company document shows that AOL carried no financial penalty if it did not sell eBay's ads, and AOL confirmed this. According to the document, AOL had a non-binding, informal commitment to reach certain ad sales targets for eBay over two quarters.

In the document, AOL projected it might have to pay eBay $40 million to $45 million in the second half of 2001 "if AOL makes ad purchases on eBay to reach the targets." AOL did not respond to The Post's question about how much of that amount it paid eBay. AOL said that another factor that showed it was the principal in the deal was that it shared "credit risk" with eBay. AOL would not explain how it shared that risk.

Several experts said that sharing the credit risk may not be enough for AOL to be considered the principal in the transaction and properly book all of eBay's revenue as its own.

If AOL had been contractually obligated to pay eBay for the full price of the ads when an advertiser failed to pay, then AOL could have been considered the principal and booked eBay's revenue, these experts said. But in its letter, AOL said it was not contractually obligated in this way.

"It seems to me AOL is not taking any of the normal risks of a merchant and, therefore, the situation seems more similar to the agent model where you should only book the margin or the net rather than the gross," said Bala Dharan, a Rice University accounting professor.

Michael Sutton, the SEC's chief accountant from 1995 to 1998, said, "This sounds more like an agency relationship than a principal relationship." An agent should book a commission, he said, not the gross sale, as AOL did.

O'Connor, the AOL executive who left the company in March, said he told company officials he was concerned that the accounting might lead to an SEC investigation.

AOL, however, said that taking all the aspects of the deal into consideration, it was reasonable to conclude that it was the principal in the transaction and it rejected the experts' opinions, saying they didn't have all the information to make the proper determination. Ernst & Young, AOL's outside auditor, reviewed the transaction and confirmed its accounting.

The company also said the amounts of money involved were a fraction of the total ad and commerce revenue and not material to the company's business.

AOL's ad-repping deal continued into 2002. In exchange for the arrangement, according to sources and documents, eBay also agreed to extend from four to five years an agreement to buy ad space on AOL's service, a deal worth an additional $18.8 million, AOL confidential documents show. EBay declined to comment on the specifics of its business dealings with AOL.

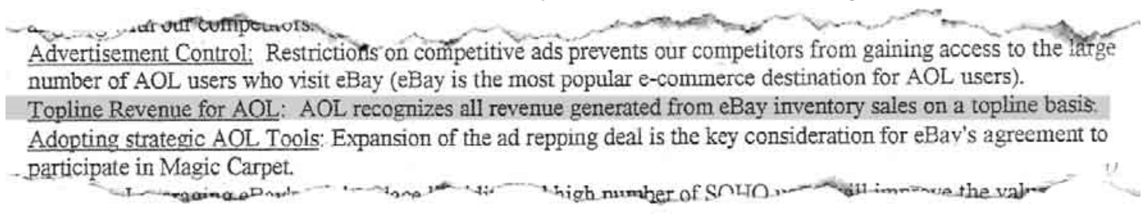
Several accounting and legal experts said the way AOL treated the eBay deal and other transactions raised broader questions about how the company was explaining its business to the public.

As with other conglomerates, AOL has been under mounting scrutiny as investors have lost confidence in corporate America's books. AOL is now being pushed by Wall Street to disclose more about how it earns its revenue and accounts for its expenses.

Accounting experts said a public company has a fundamental obligation to do its best to offer a fully formed picture of its operations. Did AOL provide enough information when it began to identify weakness in its dot-com advertising business?

Dharan, the Rice University professor, said the company did not. "They were representing something to investors," he said, "that was different from what was going on inside."

In a confidential memo, AOL executives outlined a plan to sell ads for eBay on the online auction house's own Web site. AOL then counted the full amount of sales of eBay's ads as AOL's own advertising revenue.

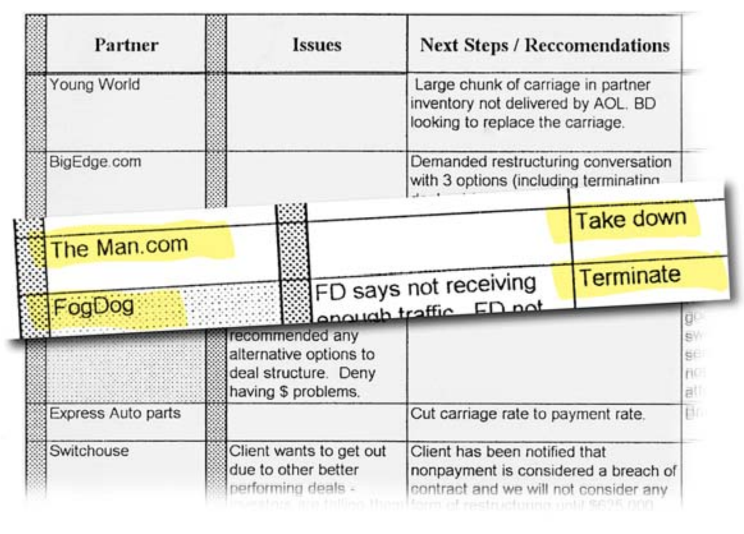


Advertisement Control: Restrictions on competitive ads prevents our competitors from gaining access to the large number of AOL users who visit eBay (eBay is the most popular e-commerce destination for AOL users).
Topline Revenue for AOL: AOL recognizes all revenue generated from eBay inventory sales on a topline basis.
Adopting strategic AOL Tools: Expansion of the ad repping deal is the key consideration for eBay's agreement to participate in Magic Carpet.

THE WASHINGTON POST

Keeping Tabs

America Online held weekly meetings in Dulles during the summer of 2000 to discuss the status of troubled dot-com deals, which one executive estimated might cost the company more than $100 million in ad revenue the following year. The company tracked deals in detailed internal reports describing the financial condition of its advertisers, how much they owed AOL and what AOL was doing to get its money.



Partner	Issues	Next Steps / Reccomendations
Young World		Large chunk of carriage in partner inventory not delivered by AOL. BD looking to replace the carriage.
BigEdge.com		Demanded restructuring conversation with 3 options (including terminating
The Man.com		Take down
FogDog	FD says not receiving enough traffic. FD not ... recommended any alternative options to deal structure. Deny having $ problems.	Terminate
Express Auto parts		Cut carriage rate to payment rate.
Switchouse	Client wants to get out due to other better performing deals -	Client has been notified that nonpayment is considered a breach of contract and we will not consider any

THE WASHINGTON POST

The Deal Makers

TODAY

How AOL Hit Its Numbers:
In the crucial period before and after its merger with media giant Time Warner, America Online used a series of unconventional business deals to keep its advertising and commerce revenue growing at a breakneck pace.

FRIDAY

AOL's Warrior Culture
America Online's freewheeling business affairs division, which rewarded aggressive practices and discouraged dissent, was key to many deals—including AOL's complicated relationship with a Las Vegas software firm.

THE DEAL MAKERS | *AOL's Warrior Culture*

Unorthodox Partnership Produced Financial Gains

Deals Allowed AOL, PurchasePro.com to Boost Revenue

By Alec Klein
Washington Post Staff Writer

At the height of the Internet boom, when America Online Inc. was king of the heap, it found an unlikely business partner: a former video store operator who had a penchant for blackjack.

In the early days of his Las Vegas start-up, Charles E. Johnson Jr. said he would go down to the neon-bathed Strip, put big wads of money on the casino tables and find a way to meet payroll.

"Junior," as he liked to be called, played for the big payday. And for a couple of heady years, his company, PurchasePro.com Inc., was the archetypal dot-com, a software venture led by a swashbuckling executive who took it public during the Internet euphoria of 1999, struck a big deal with AOL a year later and hit it rich.

AOL also profited from the partnership.

In one unorthodox arrangement, AOL gave $9.5 million in cash to PurchasePro for $30 million in stock warrants in the firm, and AOL booked the difference—$20.5 million—as ad and commerce revenue. PurchasePro also bought advertising space from AOL, and it paid AOL commissions for selling PurchasePro software.

AOL earned its warrants under a marketing deal that included distributing PurchasePro software. The warrants, similar to stock options, gave AOL the right to buy shares in PurchasePro for a penny each, according to internal company documents. AOL calculated the value of the warrants and booked it as $20.5 million in advertising and commerce revenue in its December 2000 quarter and another $7 million in the March 2001 period.

The $28 million in PurchasePro deals represented just a fraction of AOL's overall revenue. But the partnership illustrates how AOL did business at the peak of the Internet bubble, using its corporate leverage to generate advertising and commerce revenue, a key growth engine, from a dot-com firm whose fortunes were tied to the online giant.

An Unlikely Partner

Of AOL's many partners, PurchasePro was among the unlikeliest, led by a maverick who was inexperienced in the ways of technology.

Johnson is a barrel-chested former gym owner with a tuft of platinum-blond hair and a country-boy twang, by way of Lexington, Ky.

Before Johnson started PurchasePro in 1996, the 6-foot former point guard for the University of Cincinnati's basketball team said he didn't even know how to use e-mail.

His tech transformation began one day while he was working out at a gym in Las Vegas and he got to talking with casino impresario Steve Wynn.

Wynn's Mirage hotel and casino, a big operation, contracted out for many goods and services. Johnson reckoned the casino could set up a way to do its shopping on the Internet. He just needed a guy to figure out how to slap together the software to make it happen. The idea for PurchasePro.com was born.

The company soon was developing and marketing software for electronic-commerce transactions. Hotels, for example, could use the company's software to create a Web site to buy and sell bed linens and other goods and services. Hilton Hotels Corp., among others, became a customer.

It wasn't long before such online business-to-business transactions became the hot thing in 2000. AOL, always on the lookout for new opportunities, struck a deal with Johnson's start-up in March 2000.

AOL used PurchasePro's software to erect a small-business portal on AOL's Netscape site to which customers could subscribe for a monthly fee. AOL also earned a commission when it sold PurchasePro's software to other companies, which could create their own online marketplaces to buy and sell goods and services.

There was another way AOL made money: It earned $3 in performance warrants for each dollar of revenue it generated for PurchasePro under their marketing partnership. Under the agreement, the warrants gave AOL the right to buy shares in PurchasePro for $63 each. But with dot-com shares in decline, the two companies agreed to revise the deal in December 2000, according to a confidential AOL summary circulated to executives for their signatures.

As part of the revised arrangement, PurchasePro agreed to reduce the exercise price for each share of PurchasePro stock an AOL warrant could buy from $63 to a penny. AOL estimated it would earn $30 million in the quarter ended in December 2000 by exercising the warrants, according to internal company documents. AOL would buy PurchasePro stock for a penny per share and resell them at their market price.

The warrants were valuable to AOL because they were treated as ad and commerce revenue.

"$30MM [million] of revenue from performance warrants vesting in calendar Q4 [the December quarter] will be treated as advertising revenue," AOL stated in its executive summary of the deal.

For PurchasePro, a dot-com on the rise, the AOL partnership helped it to generate revenue and sell its software service.

Many cash-poor dot-coms paid for their online ads by giving AOL equity in their high-flying stock. Often such deals legitimized companies in the eyes of Wall Street because of AOL's status at the vanguard of the tech boom.

But the difference in this deal was that PurchasePro was not using its stock to buy ads to promote itself on AOL. Instead, AOL was earning warrants from selling PurchasePro software. The revenue was booked as commerce, which is reported in the same income line as advertising sales. AOL said it combines ad and commerce revenue because many of its deals are multifaceted and do not fall neatly in either of those categories.

In return for restructuring the agreement, which included reducing the warrants' exercise price, AOL agreed to give PurchasePro $10 million in revenue, according to AOL's internal documents.

PurchasePro got its $10 million this way: AOL paid it $4.9 million to cover the cost of giving 100,000 AOL customers a free month's subscription—at $49 per user—to PurchasePro's marketplace service, which was co-branded with AOL's Netscape portal. AOL also agreed to buy $4.6 million worth of PurchasePro's software, which AOL would distribute to some of its business partners. AOL would come up with another $500,000 by selling ad space on PurchasePro's online marketplace.

The bottom line: AOL essentially paid $9.5 million for $30 million in warrants, netting $20.5 million.

The deal helped AOL boost its income from ad and commerce. Though the category includes the two revenue streams, most Wall Street analysts generally regard the total as an indicator of how AOL's ad business is doing. Such assumptions could be misleading, said Johnson, the former PurchasePro chief executive.

"The warrants had nothing to do with ad revenue," Johnson said. "They were directly related to selling our marketplace software to our customers, suppliers and partners."

AOL declined to make available any officials for comment on the record. Thomas D. Yannucci, an attorney hired by AOL to answer The Post's questions, stated in a letter that the $28 million in revenue associated with the PurchasePro warrants "is de minimis when viewed against AOL's advertising and commerce revenues of $1.4 billion for the same period and AOL's total revenues of $4 billion." He said AOL had disclosed in its financial statements that it sometimes accepts various forms of equity, including warrants, as compensation for advertising and e-commerce services.

In addition, AOL's outside auditor, Ernst & Young LLP, reviewed the transaction and confirmed that AOL's accounting was in accordance with generally accepted accounting principles, Yannucci wrote.

Yannucci said the warrant revenue had been properly recognized in the ad and commerce category.

Under accounting standards, the proper treatment of the transaction depends on the details of the December restructuring that lowered the exercise price of AOL's warrants to a penny. If PurchasePro was setting a price for AOL warrants for future sales of software, the booking may have been correct.

But some accounting experts said that if PurchasePro were simply repricing AOL's existing warrants, the situation would be different. It may have been more appropriate for AOL to book that gain as "an equity investment or a completely independent investment transaction," said Bala G. Dharan, an accounting professor at Rice University.

Doug Carmichael, a professor of accounting and director of the Center for Integrity in Financial Reporting at the City University of New York's Baruch College, said, "Warrants would be an investment, whether they vested or not. If you recognize the gain on repricing, then that's an investment gain."

Yannucci said in a letter, "The change in the value of these warrants resulted from a transaction between the parties structured to increase the incentive to AOL to perform future services. In this instance, the warrants did not vest and were not owned by AOL until it had performed its obligations under the agreement."

AOL did not provide further details about the repricing.

Help Meeting Targets

As the months went by, AOL and PurchasePro found other ways to provide each other with quick infusions of revenue, often near the end of a quarter.

Under one small deal, PurchasePro would receive $1.8 million worth of advertising on the AOL service, according to an internal company document dated March 21, 2001. In return, AOL would receive $1.8 million worth of promotions that mentioned its Netscape brand when PurchasePro ran television ads on CNN and Headline News, which were now part of the merged company, AOL Time Warner Inc.

PurchasePro got little value from the ads it ran on the AOL service, according to sources and internal AOL documents that lay out where PurchasePro's ads would run.

The "carriage plan" showed that many of the PurchasePro ads would run on AOL's ICQ instant-messaging service. Instant messages allow users to converse by text in real time over the Internet. The ICQ service targets a largely teenage and international audience who would have little use for PurchasePro's business-to-business software. The ads appearing on ICQ's application also had "almost no click through," an AOL source said, meaning that few users actually clicked on the ads to find out more about the product being touted.

PurchasePro's ads also were to run on Winamp, AOL's music software player, another service that did not target PurchasePro's business clientele. A source familiar with PurchasePro's thinking said the company did not care where the ads ran. Each side was more interested in boosting its ad revenue, sources for both companies said.

The Deal's Demise

Eventually, the partnership between AOL and PurchasePro fell apart. In May 2001, Johnson stepped down as PurchasePro's CEO after the company badly missed its financial targets. In November 2001, Arthur Andersen LLP resigned as PurchasePro's independent auditor after noting what it considered deficiencies in the design and operation of PurchasePro's internal controls.

About a month after Johnson left PurchasePro, Eric Keller, an AOL senior vice president, was placed on administrative leave, pending an internal investigation of the company's relationship with PurchasePro, sources said. AOL has not publicly disclosed the internal inquiry, Keller's status or his subsequent departure. Keller declined to comment.

AOL stopped reselling PurchasePro software in the first half of 2001, according to PurchasePro officials. AOL ceased using PurchasePro's technology as the backbone of AOL's small-business portal around this February, PurchasePro said.

Chris Benyo, PurchasePro's senior vice president, said the company now has a new management team, and a different approach to marketing its products.

"Some weird [expletive] happened, but it was a valid business approach," Benyo said. "The strategy was valid, the partner was valid. The question is whether the execution was what we would have hoped it would've been."

FILE PHOTO/BY FRANK ANDERSON—LEXINGTON (KY.) HERALD-LEADER

"The warrants had nothing to do with ad revenue," says former PurchasePro.com executive Charles E. Johnson Jr. "They were directly related to selling our marketplace software to our customers, suppliers and partners."

The Deal Makers

THURSDAY

How AOL Hit Its Numbers
In the crucial period before and after its merger with media giant Time Warner, America Online used a series of unconventional business deals to keep its advertising and commerce revenue growing at a breakneck pace.

TODAY

AOL's Warrior Culture
America Online's freewheeling business affairs division, which rewarded aggressive practices and discouraged dissent, was key to many deals—including AOL's complicated relationship with a Las Vegas software firm.

Pittman Resigns From AOL Time Warner as Firm Reorganizes

PITTMAN, *From A1*

Networks, Warner Bros. pictures and Warner Music.

Ann Moore, executive vice president of Time Inc., will take over the company, which publishes magazines such as People, Time, Sports Illustrated and In Style. Chris Albrecht, president of HBO's original programming, takes over HBO.

"We have the best media, entertainment and communications businesses in the world, but our challenge—and our goal in making these changes—is to take the lessons we've learned over the past two years and use them to make the parts work together to create greater value for our shareholders," Parsons said in a prepared statement.

AOL Time Warner was assembled in a $112 billion merger between America Online, the nation's leading Internet service provider, and Time Warner Inc., a motion picture, music and publishing empire. The hope was that the combined company would achieve "synergy"—that cost reductions and cross-promotion between compatible divisions of the company would produce a revenue machine greater than the sum of its parts. Some synergy was achieved: Time has successfully sold subscriptions to its magazine on AOL.

But Pittman struggled to get all of AOL Time Warner's far-flung divisions to work together. That became all the more difficult after an advertising slump took hold in 2001 and revenue no longer flowed freely.

"The synergy strategy did not play out," said Jordan Rohan, an analyst with Soundview Technology Group, in Old Greenwich, Conn. "But more importantly it did not play out because the large online advertising deals were not efficient for advertisers. It is not that cross-selling does not work—it does—but the million-dollar, multi-year online ad deals did not work out."

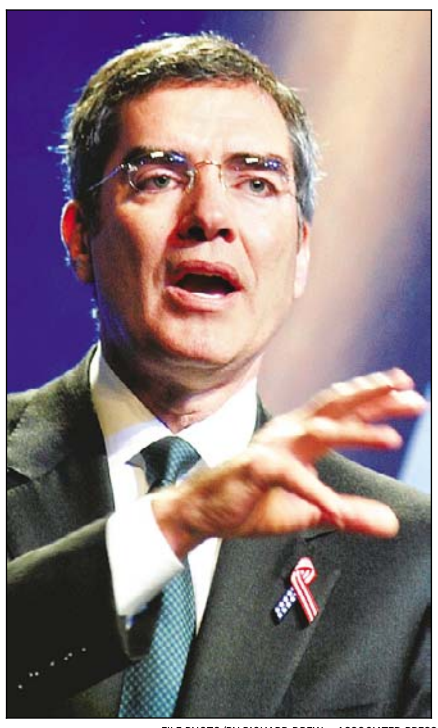
Over the past year, AOL Time Warner's stock has dropped from $47.25 to $12.45, yesterday's close after a 5 percent drop on heavy volume.

Analysts attributed yesterday's decline to the management changes and to an article in The Washington Post describing how AOL carried out a series of unconventional business deals to help generate ad and commerce revenue before and after the merger. Pittman oversaw the online service during the period.

Parsons addressed the restructuring and The Post's story in an e-mail to AOL Time Warner employees:

"I realize that these changes follow a period of tough going for our company, in which our initial expectations ran head-on into the dot-com bust, the ad recession and a general decline in investor confidence. The media scrutiny and speculation has often been intense and sometimes, as evidenced by a story in today's Washington Post, unsettling."

"Please be assured that there is absolutely no substance to any suspicions raised about America Online's advertising deals. There are no 'accounting issues' at our company. Yet we can't be satisfied with observing the law or merely doing what's required. Given who we are and what we do, we must embody a higher standard."



FILE PHOTO/BY RICHARD DREW—ASSOCIATED PRESS

Robert Pittman, 48, helped create the cable TV channels MTV, VH1, Nick at Nite and Court TV before joining AOL in 1996.

The past year has been one bad Wall Street experience after another for AOL Time Warner. In September, the company told investors that it would not make its projected earnings for 2001.

Three months later, chief executive Gerald M. Levin announced his retirement. And then, earlier this year, AOL Time Warner said it would take a $54 billion charge—the largest in U.S. business history—because the value of the stock it used to buy Time Warner had plunged.

That was a tacit admission that the deal had been overvalued, and it sparked a round of second-guessing on Wall Street about whether the combination ever made sense.

Yesterday, analysts praised the management shake-up and said Pittman's exit will be welcomed by investors who punished AOL Time Warner for setting high earnings goals and failing to reach them.

"When you push people together, then the economy started to go south and the online piece goes south and you're going into every division and telling guys you've got to give more at the office, my guess is the hostilities ran pretty deep," said Tom Wolzien, a media analyst with New York's Sanford C. Bernstein & Co.

In addition to his duties as chief operating officer, Pittman was charged with temporarily taking over the struggling America Online division, which has experienced sagging revenue and stagnant growth. Though he has submitted his resignation, Pittman will continue overseeing the unit until a permanent chief is selected, the company said.

"Having worked so hard to build the AOL service and brand, and after then going through the merger and the last 18 months, it's time to take a break," Pittman said in a prepared statement. "I'm proud of what we built at AOL and believe that it has a great future. Likewise, I have confidence in AOL Time Warner's prospects."

In the same statement, Parsons called Pittman a "brand builder and visionary, and a great manager and operating executive."

In addition to creating MTV, Pittman also helped forge VH1, Nick at Nite and Court TV. He helped overhaul the Six Flags theme parks for Time Warner Inc. before the merger. At Time Warner, Pittman clashed with Levin, according to Steve Brill, former publisher of Brill's Content, who knew both men at the time. Pittman then moved over to AOL, where he became president.

When Pittman joined AOL in 1996, the company was struggling. Competitors offered less-expensive Internet services, and AOL was grappling with an overtaxed online network, which was creating connection difficulties for its dial-up customers. Pittman spearheaded a strategy to turn AOL into a Internet marketing powerhouse, making the online service less dependent on subscriber fees for growth.

The merger of AOL and Time Warner threw Levin and Pittman back together. When Levin resigned unexpectedly as chief executive in December, some company insiders felt that Pittman had been passed over for the top AOL Time Warner job and that AOL's culture was slowly being subsumed by Time Warner's.

"In the end, AOL is just a smaller organization and didn't have the depth of management" that Time Warner has, Wolzien said. "What you've seen here is that, when they went to the bench, AOL didn't have the bench."

Staff writers Christopher Stern, Shannon Henry and Michael Barbaro contributed to this report.

The Washington Post

BUSINESS

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WashTech
Stocks

Friday, August 2, 2002

DM VA M2

Sullivan Rose By the Numbers

Deals, Detail Pushed Career at WorldCom

By Renae Merle
Washington Post Staff Writer

BY SHANNON STAPLETON—REUTERS

Former WorldCom chief financial officer Scott Sullivan being taken to court yesterday in New York.

For years, WorldCom Inc. senior management was known as "The Bernie and Scott Show." As chief financial officer, Scott D. Sullivan could—and often did—complete his boss's sentences. Bernie Ebbers laid out the vision and Sullivan provided the numbers.

Yesterday, Sullivan made a handcuffed stroll before the cameras and into custody in tasseled loafers and a dark business suit, setting the stage for more questions about how much Ebbers knew about the accounting methods Sullivan allegedly used to inflate WorldCom's profits.

"They often seemed to be two men with one brain," said Patrick McGurn, vice president at Rockville-based Institutional Shareholder Services, which represents big investors.

An attorney for Sullivan, Andrew J. Graham, was out of the office yesterday and couldn't be reached for comment.

Sullivan's roots lie in Upstate New York. He was one of the "cool guys" at Bethlehem Central High School—a member of a high school fraternity, Sigma Kappa Delta, which required paddling for admission. From there he headed to State University of New York at Oswego.

"He didn't seem like an ambitious guy. Oswego is definitely a party school," according to a high school friend. "He did not strike me as the kind that was going to grow up a successful businessman."

Still, Sullivan graduated *summa cum laude* and was recruited by six of the eight large accounting firms. He spent several years at KPMG LLP before moving to Florida to take a job at a long-distance phone company.

His partnership with Ebbers began in 1992 when WorldCom bought ATC Long Distance, where Sullivan was vice president and treasurer. Only an assistant treasurer with WorldCom at first, Sullivan made impressions inside and outside the company.

Initiating coverage of the industry, Richard Klugman, an analyst at Jefferies Jefferies & Co., remembers flying to Mississippi to meet with company executives and encountering the young accountant. "I was immediately impressed," said Klugman, who has followed WorldCom since 1993. "Scott's three big pluses—I am embarrassed to say this in hindsight—were that he had a strong grasp of the details, he had a very smart strategic view of the business . . . and he could take both of those and communicate that to the Street."

After two years Sullivan was promoted to chief financial officer, where he became a master of acquisitions from an office next to Ebbers's.

See SULLIVAN, *E4, Col. 1*

SEC Expands Probe of AOL

Query Targets Deals With PurchasePro

By Alec Klein
Washington Post Staff Writer

The Securities and Exchange Commission has widened its probe of AOL Time Warner Inc., investigating the company's former business relationship with a Las Vegas software firm.

Last week, AOL Time Warner chief executive Richard D. Parsons disclosed that the SEC had launched a fact-facting inquiry into the business practices of the world's largest Internet service, Dulles-based America Online. The Justice Department also is conducting a criminal investigation of the online unit, according to sources.

PurchasePro Inc., a struggling dot-com that markets business software, yesterday confirmed that it has been contacted by federal regulators as well. "As far as we know, the SEC is looking into our transaction with AOL that occurred under prior management," said PurchasePro spokesman Steve Stern. "Our accounting for this was conservative and appropriate, and we expect to hear further from the SEC shortly."

Stern also said PurchasePro began to withdraw from its AOL partnership last summer and terminated it in the fall of 2001.

AOL spokesman John Buckley declined to comment. SEC spokesman John Heine also declined comment.

Sources familiar with the SEC probe said the regulatory agency, which has oversight over the financial reporting of U.S. companies, has so far had only preliminary talks with attorneys for PurchasePro about its business dealings with AOL. It was unclear yesterday which aspect of the AOL-PurchasePro partnership was under review. The SEC probe follows a Washington Post report that examined various business dealings between the two companies.

In one unorthodox arrangement, AOL gave $9.5 million in cash to PurchasePro for $30 million in stock warrants in the firm, and AOL booked the difference—$20.5 mil-

See AOL, *E5, Col. 3*

Stocks Fall Sharply On Economic News

Dow Drops 230 Points; Nasdaq Off 3.6%

By Ben White
Washington Post Staff Writer

BY RICHARD DREW—ASSOCIATED PRESS

Shaky economic indicators made trading grim for Luke Scanlon on the New York Stock Exchange floor.

NEW YORK, Aug. 1—Stocks fell sharply today as a handful of new reports suggested that the economic recovery is losing steam and in danger of stalling.

The Dow Jones industrial average dropped 229.97 points, or 2.6 percent, to close at 8506.62. The broader market indexes sank as well, with the Standard & Poor's 500-stock index shedding 26.96, or 3 percent, to close at 884.66. The technology-laden Nasdaq composite index suffered the worst, losing 48.26, or 3.6 percent, to close at 1280.00.

Traders and money managers said the losses stemmed primarily from investor unease over shaky economic indicators, including a report from the Institute for Supply Management suggesting that factory production has slowed. The industry group said its business activity index fell to 50.5 last month from 56.2 in June. A reading greater than 50 signals production growth.

The Commerce Department, meanwhile, released a report showing that construction unexpectedly fell 2.2 percent in June. Analysts had predicted it would rise slightly. And the Labor Department reported that states received 387,000 initial unemployment claims last week, an increase of 20,000, the first such increase in three weeks.

The tepid figures came a day after the Federal Reserve said the economy expanded at a sluggish 1.1 percent annual rate in the second quarter, well below consensus predictions and a steep slide from

See MARKETS, *E3, Col. 3*

IMF, O'Neill Back Loans to Brazil, Uruguay

Talk of New Bailouts Helps Reverse Plunge in South American Financial Markets

By Paul Blustein
Washington Post Staff Writer

Seeking to douse a financial firestorm raging through South America, the International Monetary Fund and U.S. Treasury Secretary Paul H. O'Neill yesterday made it clear that new international loans for Brazil and Uruguay are in the works.

"Certainly there is a matter of some urgency here," said the IMF's chief spokesman, Thomas Dawson, referring to talks the IMF is holding this week with Brazilian officials on a new loan to supplement that country's current $15 billion package. An agreement to speed aid to Uruguay, which was forced to close its banks this week to halt a run by depositors, will preferably come "sooner rather than later," he added.

At a separate news conference, O'Neill—who caused a diplomatic tempest with Brazil earlier this week—took a much more conciliatory stance than he has previously, stating: "I continue to favor support for Brazil and other nations that take appropriate policy steps."

But fresh IMF aid will be forthcoming for Brazil only if the major candidates running in October's presidential election reach an "understanding" to broadly follow policies that financial markets view as credible and sensible, Dawson emphasized. The two candidates leading in the polls are both leftists who have criticized the government's pro-IMF policies, so the new approach effectively means that the onus is on them to reach some accommodation with the monetary fund lest they risk being blamed for a full-blown economic collapse.

The promising talk of new bailouts helped reverse a nosedive in Brazilian financial markets that has spread to neighboring countries in recent weeks and raised

See O'NEILL, *E2, Col. 5*

Stanley Decides Against Bermuda Reincorporation

Conn. Firm Chided for Tax Avoidance

By Ben White
Washington Post Staff Writer

Stanley Works, the Connecticut-based tool manufacturer, said late yesterday that it has reversed a move to change its official address to Bermuda.

The decision comes after the company was widely criticized for considering the move, which would have reduced its U.S. tax burden. Members of the AFL-CIO protested the plan earlier this week outside the company's New Britain, Conn., headquarters and members of Congress from both parties have urged Stanley Works to reconsider.

In a prepared statement, Stanley said it changed its mind because "Congress has started down a path to deliver comprehensive tax reform that would eliminate the inequities of U.S. international taxation and thereby accomplish Stanley's original and continuing goal."

"We have been asked by the congressional leadership on both sides of the aisle to support their efforts toward rectifying this situation. . . . We have honored their request, and the ball is now in their court," Stanley chief executive John M. Trani said in a statement.

The planned reincorporation in Bermuda has been a central issue in a pivotal Connecticut congressional campaign between Republican Rep. Nancy L. Johnson and Democratic Rep. James H. Maloney, who are battling for a 5th District seat that was redrawn based on population

See STANLEY, *E3, Col. 3*

INSIDE

Deputy AG Profited Before Stock Fell

Thompson Exercised Providian Options During Transition

By Anitha Reddy
Washington Post Staff Writer

FILE PHOTO BY BILL O'LEARY—THE WASHINGTON POST

Deputy Attorney General Larry D. Thompson, left, disclosed his personal profit from selling stock and options in Providian, where he was a director.

Larry D. Thompson, head of the federal task force on corporate fraud and former director of Providian Financial Corp., made a profit of between $1 million and $5 million when he exercised his Providian stock options in July 2001, according to his annual financial disclosure statement released yesterday.

Thompson, who was also chairman of the troubled credit card firm's audit committee until his resignation to become U.S. deputy attorney general in May 2001, exercised his options and sold Providian stock worth nearly $5 million in a series of transactions in early July last year, according to the disclosure statement. His total profit from the transactions remained uncertain, however, be-

See PROVIDIAN, *E2, Col. 1*

DOW 8506.62 DOWN 229.97, 2.6%	**NASDAQ 1280.00** DOWN 48.26, 3.6%	**STANDARD & POOR'S 500** 884.66, DOWN 26.96, 3.0%	**WASH. POST-BLOOMBERG** REGIONAL 145.74, DOWN 1.30, 0.9%	**10-YEAR TREASURY NOTE** UP $5.63 PER $1,000, 4.39% YIELD	**CURRENCIES** 119.36 YEN=$1, EURO=$0.9834

The Washington Post

BUSINESS

Tuesday, July 30, 2002

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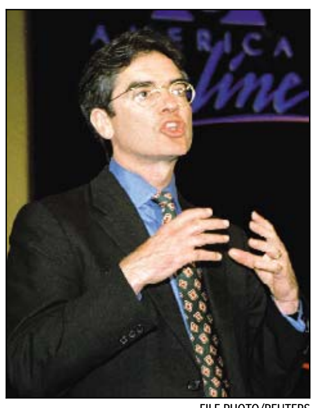


FILE PHOTO/REUTERS

Robert W. Pittman resigned as chief operating officer of AOL Time Warner on July 18.

FILE PHOTO/ASSOCIATED PRESS

Vivendi Universal's board fired Chairman Jean-Marie Messier earlier this month.

FILE PHOTO/ASSOCIATED PRESS

Thomas Middelhoff, who as chairman and chief executive of Bertelsmann AG oversaw its purchase of Napster, was ousted on Sunday.

Moguls on a Downhill Slope

With Bertelsmann Ouster, Another Media Giant Eschews Vision for Revenue

By Frank Ahrens
Washington Post Staff Writer

It's a tough time to be a media lord pushing tomorrow's ideas.

The weekend ouster of Thomas Middelhoff, chief executive of Germany's Bertelsmann AG—one of the world's top five media companies—is only the most recent expulsion from a quickly shrinking club that once sought to change the way consumers get their entertainment.

Earlier this month, the board of directors of France's Vivendi Universal SA—the world's second-largest media firm—tossed out its star-struck chief executive, Jean-Marie Messier, who briefly sold his company on a dream of Parisian teenagers watching movies on their cell phones.

A little over a week ago, Robert W. Pittman, chief operating officer of AOL Time Warner Inc.—the world's largest media conglomerate—resigned after failing to integrate the sprawling company's many assets into a streamlined, moneymaking whole by delivering Time Warner movies, music and magazines via America Online and Time Warner Cable.

For his part, Middelhoff spent the past four years trying to turn a 167-year-old publishing company—which began by printing Christian songbooks—into an international music, software, online, book and magazine company.

Best known in the United States as corporate parent of BMG Entertainment, which carries artists such as Aretha Franklin, Outkast, the Dave Matthews Band and Dolly Parton, Bertelsmann even bought the Napster file-sharing site last year for $9 million and $91 million in forgiven loans and advances.

It was a bold move by Middelhoff, 49, who split with the other major music labels by acquiring the renegade online site, which was by then shut down by music industry lawsuits. It was a tacit admission that the file-swapping service had all but rendered obsolete the music industry's traditional means of distributing and selling

See MOGULS, E4, Col. 1

Merrill Ties To Enron At Issue In Probe

Senate Panel to Look At Firms' Relationship

By Carrie Johnson
Washington Post Staff Writer

Senate investigators cited internal e-mails and memos from Merrill Lynch & Co. to detail three occasions in which officials at the investment bank came to the aid of Enron Corp. in an effort to curry favor with the Houston energy trader.

In April 1998, after Enron leaders complained about their low stock rating by a Merrill research analyst, then-president Herb Allison called to mollify Enron Chairman Kenneth L. Lay—and improve Merrill's chances of taking part in a lucrative deal with Enron, investigators said.

Stock analyst John Olson left Merrill four months later and a new analyst, Donato Eassey, lifted Enron's rating from "neutral" to "accumulate" that fall. The move was praised by Merrill's bankers and Enron executives, who sent the firm business worth $40 million to $50 million, according to an e-mail quoted by the investigators.

"It is clear that your responsive message was appreciated by the Company, and any animosity in that regard [relating to Enron's stock rating] seems to have dissipated in the ensuing

See MERRILL, E4, Col. 1

Arbitration Standards Challenged

By Caroline E. Mayer
Washington Post Staff Writer

The securities industry is pushing the state of California to exempt arbitrators that handle disputes against stock brokerages from new arbitration ethics standards that require more disclosure of conflicts of interests.

The National Association of Securities Dealers' Dispute Resolution division and the New York Stock Exchange sued the California Judicial Council last week, saying their own arbitration rules require arbitrators to disclose any possible conflicts of interest. They said their procedures are regulated by the Securities and Exchange Commission to make sure the private judgment process is as fair as the public court system. They are also concerned about the costs and complexities especially if other states follow California's lead and impose different sets of rules.

Almost all stock brokerage firms require investors to agree when they open their accounts to waive their rights to a court trial and refer all disputes to arbitration. The NASD and NYSE handle almost all investor complaints brought against stockbrokers, which are estimated to total more than 5,000 cases this year. The number of cases has been rising rapidly in the past three years as more households own stocks and

See ARBITRATION, E4, Col. 1

In Brazil, 'Ill Will' Over O'Neill

Treasury Chief's Remarks Cause Diplomatic Stir, Weaken Currency

By Paul Blustein
Washington Post Staff Writer

For the second time in five weeks, comments by Treasury Secretary Paul H. O'Neill sent Brazil's currency plunging yesterday—and this time, a diplomatic incident ensued.

Foreign Minister Celso Lafer summoned U.S. Ambassador Donna Hrinak to complain of "profound ill will" generated by remarks that O'Neill made in a televised interview Sunday, which traders interpreted as suggesting that Washington will oppose new international aid for Brazil's crisis-stricken economy. Brazilian officials were particularly exercised over the Treasury secretary's assertion that he wants to make sure such aid won't "just go out of the country to Swiss bank accounts."

The episode came amid mounting concern that Brazil, Latin America's largest economy by far, is sinking into the sort of financial conflagration that has devastated Argentina. The government announced late yesterday that it will send a team of officials to the International Monetary Fund's Washington headquarters to discuss a possible increase or extension in a $15 billion loan program that expires late this year, according to wire service reports from Brazil.

Thanks in large part to investor concerns that a leftist candidate will win October's presidential election, the Brazilian real has lost more than a quarter of its value against the U.S. dollar this year, and the nation's bonds have plummeted. Those factors have forced the government to pay very high interest rates to borrow money and are stoking worries that Brazil may be forced to default on its $300 billion-plus debt, as Buenos Aires did.

O'Neill's tart tongue has generated controversy on numerous occasions during his stewardship at the Treasury, but drawing a formal protest from another nation's foreign minister is a first for the Treasury chief, according to his aides, who maintained that he had been misunderstood by both the markets and the Brazilians.

Ironically, the comments that caused the latest flap came as O'Neill was defending himself on Sunday talk shows against criticism that he lacks the deft touch of his Democratic predecessor, Robert E. Rubin, in calming financial

See REAL, E4, Col. 5

BY PAULO WHITAKER—REUTERS

A trader stands by a U.S. dollar exchange rate board at the futures and commodities market in Sao Paulo, Brazil, yesterday.

Qwest Move Puts Focus On Trades

By Anitha Reddy
Washington Post Staff Writer

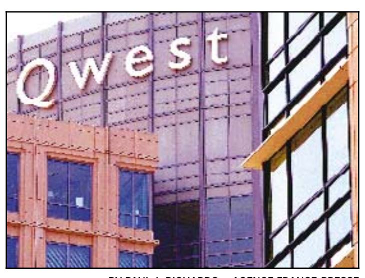
The telecommunication industry's widespread practice of trading communications capacity to build worldwide networks came under renewed scrutiny this week after Qwest Communications International Inc. announced it incorrectly booked as much as $1.16 billion from the deals.

Qwest, the dominant local phone provider in 14 western states, became the first major telecommunications company to declare its intention to restate earnings because of the practice, saying it improperly recorded revenue in 18 percent of its swaps in the years before and after its 2000 merger with US West Inc.

"Accounting errors were made," Qwest's chief executive, Richard C. Notebaert, said in a conference call for investors yesterday. "They will be corrected and they will be disclosed."

Afshin Mohebbi, Qwest's president and chief operating officer, is scheduled to testify today in a Senate Commerce, Science and Transportation Committee hearing on the accounting crisis in the telecommunications industry. The head of the Federal Communications Commission, Michael K. Powell; the chief executive of telecommunications upstart Global Crossing,

See QWEST, E3, Col. 4



BY PAUL J. RICHARDS—AGENCE FRANCE-PRESSE

Qwest, which has offices in Arlington, announced that it will restate $1.16 billion in earnings.

AOL, MetLife on Panel Of WorldCom Creditors

By Bruce Meyerson
Associated Press

NEW YORK, July 29—AOL Time Warner, EDS and MetLife were among 15 parties chosen today to serve on the committee that will represent thousands of creditors owed billions of dollars in WorldCom's bankruptcy.

Also today, WorldCom named John S. Dubel its new chief financial officer and Gregory F. Rayburn chief restructuring officer in the telephone and Internet service company's bid to reorganize its debts and operations.

Dubel replaces Scott Sullivan, the ousted CFO who is expected to face criminal charges in WorldCom's accounting scandal. Dubel and Rayburn, both principals with the restructuring firm AlixPartners, attended today's creditors' meeting along with WorldCom chief executive John W. Sidgmore.

The Nasdaq Stock Market, meanwhile, announced that it will delist the nearly worthless shares of WorldCom and its MCI long-distance unit. The move, effective Tuesday, was blamed on the bankruptcy case and WorldCom's inability to stay up to date with the federal filing requirements for public companies.

The creditors committee was selected from among 51 parties that submitted applications to Carolyn S. Schwartz, the U.S. trustee handling the WorldCom case for the Justice Department.

The committee is to negotiate what portion of their debts the creditors would be repaid when WorldCom emerges from bankruptcy, as well as how much stock in a reorga-

See WORLDCOM, E3, Col. 4

AOL TIME WARNER

David Colburn is known for his brash style.

Dealmaker At AOL to Shift Focus

Colburn Giving Up Day-to-Day Duties

By Alec Klein
Washington Post Staff Writer

AOL Time Warner Inc.'s top dealmaker is relinquishing day-to-day oversight of the business affairs division of the world's largest Internet service, according to company sources familiar with the matter.

David M. Colburn, known by many in the industry for his brash and aggressive style, will no longer handle the business deals brokered by America Online, the sources said. He will, however, continue to work on strategy and other broad issues, they said.

Colburn's day-to-day duties are being handed to Lance Conn, who is returning to Dulles from London, where he helped expand the

See AOL, E2, Col. 1

DOW 8711.88 UP 447.49, 5.4%	**NASDAQ 1335.25** UP 73.13, 5.8%	**STANDARD & POOR'S 500** 898.96, UP 46.12, 5.4%	**WASH. POST-BLOOMBERG** REGIONAL 146.13, UP 5.43, 3.9%	**10-YEAR TREASURY NOTE** DOWN $13.44 PER $1,000, 4.56% YIELD	**CURRENCIES** 119.79 YEN=$1, EURO=$0.9809

Treasury to Increase Borrowing

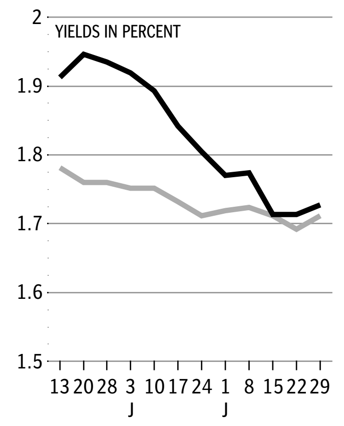
The Treasury Department said it plans to borrow $76 billion in the July-September period, $21 billion more than projected three months ago. It now also expects to have $40 billion in cash on hand at the end of the period, $5 billion less than forecast. An even larger gap occurred in the second quarter, when the Treasury hoped to pay down $89 billion in debt and ended up borrowing $15 billion. Falling tax receipts and rising spending, much of it for homeland security and military operations in Afghanistan, are boosting the budget deficit.

Fewer Internet Domain Names

The number of Internet domain names has contracted sharply in the past year, the first such reduction since the Web popularized the Internet, according to the latest surveys of the world's top 10 registrars of Internet names. Since reaching a peak of about 30.6 million in September, the number of Net addresses ending in ".com," ".net" and ".org" has dropped by more than 1.6 million through May—a 14 percent decline.

Treasury Bills

13-wk: 1.712% 26-wk: 1.727%



SOURCE: Treasury Department

THE WASHINGTON POST

COURTESY OF TOYOTA

Toyota employees and executives celebrate the 10 millionth vehicle built at the Japanese company's plant in Georgetown, Ky. Toyota has been manufacturing vehicles in North America for 16 years.

MORE NEWS

Budget Group, the parent of Budget Rent-A-Car and Ryder truck rental, filed for Chapter 11 bankruptcy protection, blaming the post-Sept. 11 drop-off in travel. The company said customers will not be affected by the filing in U.S. Bankruptcy Court in Wilmington, Del. The Daytona Beach, Fla.-based group listed assets of $4.05 billion and debts of $4.33 billion.

The Securities and Exchange Commission posted a new Web site naming executives who have certified the accuracy of their companies' financial statements in compliance with a new rule. The rule requires that chief executives and chief financial officers of 947 U.S. companies attest that financial reports filed with the agency are accurate and complete.

Bill Gates's personal investment fund and charity raised its stake in Cox Communications to 33.4 million Class A shares. The combined stake of Gates's Cascade Investment fund and the Bill & Melinda Gates Foundation amounts to 5.8 percent of the Class A common shares outstanding of Cox.

Gates also said the company is forming a board of about 15 university professors to provide advice on security and privacy issues as the world's biggest software maker tries to improve its reputation in both areas.

T-bill rates rose. The discount rate on three-month Treasury bills auctioned yesterday rose to 1.680 percent, from 1.660 percent the previous week. Rates on six-month bills rose to 1.690 percent, from 1.675 percent. The actual return to investors is 1.712 percent for three-month bills, with a $10,000 bill selling for $9,957.50, and 1.727 percent for a six-month bill selling for $9,914.60. Separately, the Federal Reserve said the average yield on one-year Treasury bills, a popular index for changing adjustable-rate mortgages, fell to 1.88 percent from 1.97 percent last week.

BY ITSUO INOUYE—ASSOCIATED PRESS

Honda's executive vice president, Koichi Amemiya, announces that the automaker's profits for the first fiscal quarter jumped 20 percent from a year ago, lifted by strong overseas sales and a favorable exchange rate.

Computer Associates International, the world's fifth-largest software maker, said it will begin treating stock options as expenses starting in April, a move that will trim its annual earnings by 2 cents a share.

Dynegy agreed to sell a natural gas pipeline for $928 million in cash and $950 million in assumed debt to MidAmerican Energy Holdings, a unit of Warren Buffett's Berkshire Hathaway that has been buying energy assets. The 16,600-mile Northern Natural Gas pipeline system runs from Texas to the Great Lakes.

AOL Time Warner and AT&T agreed to temporarily suspend the registration process for AT&T's stake in their joint venture, Time Warner Entertainment, according to sources familiar with the matter. AT&T and AOL Time Warner are negotiating an alternate transaction aimed at unwinding the partnership.

Adelphia Communications' founder and chairman, John J. Rigas, personally ran up as much as $66.9 million in advances from the cable television company's cash management account, federal investigators allege. At some point, the investigators say, his son and vice president for finance, Timothy Rigas, reined in the withdrawals, limiting his father to a $1 million-a-month maximum.

The National Highway Traffic Safety Administration has upgraded its investigation into more than 300 complaints about air-bag problems in the 1997 Ford Escort and Mercury Tracer. The probe covers 396,208 vehicles and reports of 23 fires, 21 inadvertent air-bag deployments and five injuries. NHTSA also opened an investigation into 30 accidents in which air bags did not deploy in the 2001 Kia Rio, according to reports of actions taken by the agency in June. One person was killed and 26 injured in the crashes.

EARNINGS

Humana reported second-quarter earnings of $45.4 million, up 19 percent from the year-ago period. The health-care provider's revenue rose to $2.83 billion, from $2.49 billion a year earlier.

Tyson Foods said its fiscal third-quarter profit jumped almost six-fold, to $109 million, as a result of higher chicken prices and growth from its purchase of beef and pork processor IBP. Revenue tripled to $5.9 billion.

Kellogg said second-quarter profit rose 52 percent, to $173.8 million, because of lower costs related to last year's purchase of Keebler Foods and higher sales.

LOCAL BUSINESS

AES shares rose 41 percent, the Arlington-based power producer's biggest one-day gain ever, after its partner in a California electric plant said it may soon settle a dispute with the state over millions of dollars in power sales. Shares of the company, which does business in 33 countries, rose 64 cents, to $2.20 on the New York Stock Exchange.

Coventry Health Care of Bethesda said its second-quarter profit jumped 79 percent, to $36.6 million, as the company's member enrollment and commercial rates rose.

Rouse Co. of Columbia said its second-quarter profit was $98.1 million on revenue of $277.4 million, compared with $25.9 million on $269.9 million in revenue for the same period last year. Funds from operations rose 8.5 percent, to $73.7 million, for the period ended June 30, driven by growth from Rouse's purchase in May of eight malls and other assets from shopping center developer Rodamco North America NV.

Compiled from reports by the Associated Press, Bloomberg News, Dow Jones News Service and Washington Post staff writers

DILBERT *By Scott Adams*

Colburn's Duties to Change at AOL

AOL, *From E1*

Internet division's reach throughout England, France and other parts of the continent. Conn, a 34-year-old lawyer, joined America Online in 1996.

Conn said he will be back in the United States permanently on Sept. 1.

America Online spokesman John Buckley confirmed the personnel change. "Lance is a terrific person to be taking on new responsibilities," Buckley said. "He will continue to look to David [Colburn] for his supervision and guidance. And this is all part of ongoing efforts to make deal flows work smoother and better."

In his new role, Conn will make the final review of and sign off on deals put together by the business affairs unit, roles previously played by Colburn. The deals often involve some of the largest and most complex advertising deals between AOL and companies wishing to market themselves on the Internet service. Reporting to Conn will be senior vice presidents Steven Rindner, Ted Prince and Gio Hunt.

Conn will retain his title as senior vice president and continue to report to Colburn. Conn also will assume some of the responsibilities of Adam Lehman, who recently left business affairs, where he essentially served as chief operating officer of the unit.

Colburn may still get involved in some negotiations with select business partners, and he retains his post as executive vice president and president of business affairs and development for AOL Time Warner's subscription services and its advertising and commerce businesses. Colburn reported to Robert W. Pittman, who resigned under pressure earlier this month as AOL Time Warner's chief operating officer.

The company said Colburn was vacationing in Israel and was unavailable for comment.

Colburn, a lawyer, former venture capitalist and former chief executive of a poster company, played a major role in building America Online into a marketing powerhouse during the late 1990s, leading a unit of about 100 dealmakers who brokered hundreds of millions of dollars in advertising and commerce contracts.

Now, however, the online division's advertising revenue is in a deep swoon. In its just-ended second quarter, the Internet unit's ad and commerce revenue dropped 42 percent. On the same day, AOL Time Warner announced that the Securities and Exchange Commission is conducting a probe of the online unit following a Washington Post report about how the division generated advertising and commerce revenue through a series of unconventional deals.

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RWD Technologies Considering Move From Howard County

By Sabrina Jones
Washington Post Staff Writer

RWD Technologies Inc., one of Howard County's largest companies, said yesterday that it may move its headquarters from Columbia after its lease expires in 2003, dealing another blow to the county's sputtering technology industry.

The technology services and consulting firm's chief executive, Robert W. Deutsch, said yesterday that the company would move its 600-person Howard workforce to RWD's new Applied Technology Laboratory, in a 63,000-square-foot building adjacent to the University of Maryland, Baltimore County. RWD now employs about 160 to 170 people at the laboratory, the base of RWD's financially struggling Latitude360 division, which sells e-learning products.

RWD's chief financial officer, Beth M. Buck, said the decision to move is not final yet.

"That is not a decision that has been made," Buck said. "That's one of several things we're considering."

The company's lease expires in December 2003, Buck said. RWD is also looking at sites in Columbia and will choose a location for its headquarters by May or June.

The company now occupies four floors in a 138,000-square-foot building in Columbia Town Center, where it has been for about a decade. RWD wants a new location with fewer floors and more space.

RWD, whose sales have been hurt in recent years by companies that are cutting back on information technology spending, recently implemented a series of cost-cutting measures, including reducing its workforce through layoffs and attrition, dropping from 1,074 in June 2001 to 917 in June of this year.

The company reported last week that its second-quarter loss widened to $2.2 million (14 cents per share), from $1.6 million (10 cents) in the same period in 2001, and that it expects to fall short of its 2002 earnings projections. The company had said previously that it would earn 20 cents per share for the fiscal year. RWD shares lost 6 cents yesterday to close at $2.14, down 2.8 percent.

RWD is among the largest companies in Howard County and is the largest tenant in its Columbia high-rise office building, said Linda H. Wilson, executive vice president of the Howard County Economic Development Authority.

"It is certainly the type of company that we would want to retain, and we will work to keep them in Howard County," Wilson said. "They are the type of company we feel certainly benefits Howard County."

The county's technology sector has seen a widespread fallout in the past few years. Last year, Israeli firm Trellis Photonics Ltd. shut down its U.S. operations in Columbia and halted construction of a 60,000-square-foot manufacturing plant. In June, Corvis Corp., a Columbia fiber-optics firm, laid off 240 workers, including 70 in its Howard corporate office.

Then last month, Bookham Technology PLC, a British optical products firm, announced that it will close its 150,000-square-foot Columbia plant later this year, laying off 45 workers. That was followed by Florida-based server-software firm Citrix Systems Inc.'s layoff of 100 Columbia workers when it closed its office, the former headquarters of Sequoia Software, a portal software firm. Citrix bought Sequoia last year for $185 million.

"It's always a balancing act," Wilson said. "You have an influx of companies coming in, and then you have the slump. That's typical. That's part of economic development, the ebbs and the flows."

GenVec Quarterly Loss Grows 84%

By Ellen McCarthy
Washington Post Staff Writer

Increased research and development spending along with a drop in payments from partners drove GenVec Inc.'s second-quarter loss up 84 percent, the company said yesterday.

The Gaithersburg biotechnology firm lost $6.9 million (32 cents a share) in the three months ended June 30, compared with a loss of $3.8 million (21 cents) in the year-earlier period. Quarterly revenue fell to $1.6 million, down 23 percent from $2 million in the same period of 2001.

"The operating expenses and the increases that we saw are primarily attributed to the clinical costs," said Jeffrey W. Church, GenVec's chief financial officer. "That's just the cost of doing business when you're advancing products through the clinic. It's an expensive process but one that we have planned for."

The company develops gene-based medicines, including one, BioBypass, that is being studied as a potential candidate to treat patients with coronary heart disease and other cardiovascular diseases.

Pharmaceutical giant Pfizer Inc. had been collaborating with GenVec on BioBypass but announced in January that it would end the partnership. Rockville-based Bio-Reliance Corp. will pick up some of the manufacturing work that was done by Pfizer as a result of an agreement reached earlier this month. Church said the absence of contract, license and milestone payments, which accounted for $850,000 in revenue in the year-earlier period, resulted from the conclusion of the Pfizer partnership.

The company ended the quarter with $31.8 million in cash and investments; Church said that should last the company through the second or third quarter of 2003.

"But between now and then we'll have advanced in the trials, which will continue to add value to our company. We are hopeful that that will translate into a high stock price and open up equity markets," he said. "In addition we are looking at corporate partnerships around each of our programs."

Shares of GenVec rose 12 cents yesterday, to $3.40.

Primus Posts Loss, Reports Less Debt

By Yuki Noguchi
Washington Post Staff Writer

Primus Telecommunications Group Inc. of McLean posted a loss on slightly decreased revenue during its second quarter, but the company said it has reduced its debt and will not require additional funding for the foreseeable future.

The company posted a loss of $11.6 million (18 cents a share) on revenue of $251.2 million in the quarter ended June 30. That compared with earnings of $116.1 million ($2.21) on revenue of $271.1 million a year earlier.

Primus sells telecommunications and Internet services and is better known outside the United States, from which it derives about three-quarters of its revenue.

One of the hallmarks of Primus's financial results over the past year and a half has been its reduction in debt. Since the beginning of 2001, the company has been repurchasing its bonds on the open market, reducing its debt from $1.3 billion to $615 million. As a result of those reductions, Primus's interest payments decreased to $16.8 million during the quarter, from about $32 million in the same period a year ago.

The company has also been selling unprofitable businesses, lowering its revenue to reduce expenses.

Analysts praised the results.

"For awhile, they were clinging for life, but at the present, they're out of the woods," said Chris Roberts, a research analyst for brokerage firm Tejas Securities Group in Austin, which has no investments or banking relationship with Primus. "They are right on track. The results are very favorable in light of the current telecom market."

The company said it expects revenue for this year to be more than $1 billion, and said its earnings before interest, taxes, depreciation and amortization would be between $95 million and $100 million during the year—more than it had initially expected.

"This performance is all the more remarkable considering the devastation occurring in the industry," John DePodesta, cofounder and executive vice president of Primus, said in a conference call with analysts.

The financial results were released after the markets closed. Shares of Primus closed at 73 cents, down 2 cents.

Separately, Primus chief executive K. Paul Singh testified yesterday in federal district court in Alexandria as a defendant in a lawsuit brought by investors in Tutornet.com Group, an online venture in which Primus had proposed to invest up to $400,000 three years ago. Primus had proposed to purchase 19.9 percent of Tutornet, which was later charged with fraud by the Securities and Exchange Commission. Tutornet settled those charges for $55,000 in October 2000.

Tutornet's investors are now attempting to recover damages from Primus, charging that Primus essentially controlled Tutornet through a wholly owned subsidiary. If Primus or some of its executives are found responsible, it may be liable for an unknown amount of damages.

Primus has characterized the $300,000 it handed over to Tutornet as an advance, not an investment. Primus spokesman Jordan Darrow declined to comment on pending litigation.

IN BRIEF

■ **Maximus**, a Reston government contracting firm, said it earned $11.1 million (48 cents a share) in the three months ended June 30. The firm earned $11.8 million (53 cents) in the same period of 2001. Fiscal third-quarter revenue rose to $133.1 million, from $130.6 million a year earlier. Maximus said it expects to post revenue from $136 million to $142 million and per-share earnings between 50 cents and 53 cents for its fiscal fourth quarter. Shares of Maximus rose $2.18, or 9.2 percent, to close at $25.90.

■ **On-Site Sourcing**, an Alexandria firm that provides document-management technology, said it earned $541,474 (10 cents a share) in the three months ended June 30. In the same period of 2001, On-Site earned $420,233 (8 cents). Second-quarter revenue fell slightly, to $10.31 million from $10.33 million a year earlier. On-Site said it expects to post earnings from 30 cents to 34 cents a share for the year, but it warned that 2002 revenue will be lower than the $44 million to $46 million predicted earlier. Shares of On-Site closed at $2.92, up 16 cents.

■ **Sitel**, a Baltimore company that provides call-center services, said it earned $3.5 million (5 cents a share) in the three months ended June 30, up from a loss of $30.2 million (41 cents) in the same period in 2001. Second-quarter revenue was $196.7 million; it was $177.8 million a year earlier. Sitel ended the quarter with a cash balance of $28.8 million and said it expects to post revenue from $190 million to $194 million in the third quarter. Shares of Sitel rose 5 cents, to close at $2.25.

■ **Meridian Medical Technologies**, a Columbia firm that provides drug delivery and diagnostic systems, said it signed a contract with the Canadian Department of National Defense to design and manufacture an auto-injector to administer a nerve agent antidote. The injector is to keep the antidote, which can be self-administered, in a dry, stable form until it is used. Terms of the contract were not disclosed.

■ **Lockheed Martin**, a Bethesda defense contractor, sold its Formtek database-management unit to closely held DFI International because it no longer considered the business essential. Terms weren't disclosed. DFI, a Washington-based management consulting company, bought Formtek through its SwannStreet Ventures investment arm, the companies said. The purchase was financed with private equity, led by Resource Ventures. Lockheed has said it plans to sell its 81 percent stake in Comsat International's Latin American operation to World Data Consortium and to shed other telecommunications investments. Washington-based Formtek serves more than 50 corporate clients and more than 40,000 users. Its customers include aerospace and defense companies, automakers, manufacturers, telecommunications companies and utilities in North America, Europe and Asia. The unit has 21 employees and was acquired by Lockheed in 1989.

Compiled from reports by Washington Post staff writers, washingtonpost.com and Bloomberg News

AOL-PurchasePro Deals Subject to SEC Scrutiny

AOL, From E1

lion—as ad and commerce revenue. PurchasePro also bought advertising space from AOL and paid AOL commissions for selling PurchasePro software.

AOL earned its warrants under a marketing deal that included distributing PurchasePro software. The warrants, similar to stock options, gave AOL the right to buy shares in PurchasePro for 1 cent each, according to internal company documents. AOL calculated the value of the warrants and booked it as $20.5 million in advertising and commerce revenue in the quarter ended December 2000 and another $7 million in the quarter ended March 2001.

The PurchasePro deal was one of several unconventional transactions carried out by AOL at a critical time before and after its takeover of Time Warner Inc. in January 2001.

AOL has said it booked these deals properly, and its outside auditor Ernst & Young LLP has confirmed the accounting.

At least two AOL executives have already retained attorneys in connection with the company's partnership with PurchasePro, sources said. That includes Myer Berlow, a former AOL advertising executive who now is a company consultant, and David M. Colburn, executive vice president and president of business affairs and development for AOL Time Warner's subscription services and advertising and commerce businesses, the sources said. The firm declined to make Berlow or Colburn available for comment.

Colburn recently relinquished his day-to-day duties overseeing the Internet division's business affairs unit, which negotiated many of the company's unconventional transactions. Colburn's move follows the recent resignation announcement of Robert W. Pittman as AOL Time Warner's chief operating officer.

PurchasePro has faced its own turmoil—widening financial losses, hundreds of layoffs and a plunging stock price that closed yesterday at 33 cents. In November 2001, Arthur Andersen LLP resigned as PurchasePro's independent auditor after noting what it considered deficiencies in the design and operation of PurchasePro's internal controls.

Also last year, Eric Keller, an AOL senior vice president, was placed on administrative leave, pending an internal investigation of the company's relationship with PurchasePro, sources said.