UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE WORLDCOM, INC. SECURITIES LITIGATION	:	MASTER FILE NO. 02 Civ. 3288 (DLC)
This Document Relates to: All Actions	:	

MEMORANDUM OF LAW OF LEAD PLAINTIFF ALAN G. HEVESI, COMPTROLLER OF THE STATE OF NEW YORK, AS ADMINISTRATIVE HEAD OF THE NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS AND AS TRUSTEE OF THE NEW YORK STATE COMMON RETIREMENT FUND, IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS THE CLASS ACTION COMPLAINT

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Alan G. Hevesi, Comptroller of the State of New York, as Administrative Head of the New York State and Local Retirement Systems and as Trustee of the New York State Common Retirement Fund (the "NYSCRF" or "Lead Plaintiff"), respectfully submits this memorandum of law in opposition to the motions to dismiss filed by Defendants Salomon Smith Barney Inc. ("Salomon"), Banc of America Securities LLC, Deutsche Bank Alex. Brown Inc. (n/k/a Deutsche Bank Securities, Inc.), Chase Securities Inc. (n/k/a J.P. Morgan Securities Inc.), Lehman Brothers Inc., Blaylock & Partners, L.P., Credit Suisse First Boston Corporation, Goldman, Sachs & Co., UBS Warburg LLC, ABN AMRO Incorporated, Utendahl Capital Partners, L.P., BNP Paribas Securities Corp., Fleet Securities, Inc. and J.P. Morgan Chase & Co. (together, the "Underwriter Defendants");[1] Citigroup, Inc., Salomon and Jack Grubman (together, the "Salomon Defendants"); Clifford Alexander, Jr., James Allen, Judith Areen, Carl Aycock, Max Bobbitt, Francesco Galesi, Stiles Kellett, Jr., Gordon Macklin, John Porter, Bert Roberts, Jr., John Sidgmore, and Lawrence Tucker (together, the "Director Defendants"); Arthur Andersen LLP ("Andersen") and Melvin Dick ("Dick") (together, the "Andersen Defendants");[2] and

Bernard Ebbers.[3]

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[1] Lead Plaintiff is in the process of serving four non-moving underwriters named in its complaint -- Caboto Holding SIM S.p.A., Mizuho International plc, Tokyo-Mitsubishi International plc, and Westdeutsche Landesbank Girozentrale (n/k/a WestLB AG) -- through the Hague Convention. Counsel for the Underwriter Defendants have indicated that they have asked these Defendants for permission to accept service on their behalf.

[2] Lead Plaintiff has yet to locate and serve former Andersen partner Mark Schoppet, and Andersen's counsel has refused to accept service on this Defendant's behalf. Counsel for Defendants Arthur Andersen UK and Andersen Worldwide SC have recently accepted service and requested extensions of their time to respond to the complaint. The NYSCRF agreed to those requests, and the parties will submit a proposed briefing schedule to the Court shortly.

[3] On December 5, 2002, the Court granted the motions of Defendants Scott Sullivan and David Myers for a stay of further proceedings against them in both this litigation and the parallel WorldCom ERISA litigation until the criminal charges pending against them in this District have been

PRELIMINARY STATEMENT

With one notable exception, the motions to dismiss ask this Court to conclude, at this preliminary stage, that none of the gatekeepers on whom the investing public relied should be required to answer for their role in the largest corporate debacle in history. Rather than answer the detailed allegations of the NYSCRF's Class Action Complaint ("Complaint"), the moving Defendants raise a host of legal and technical challenges intended to deny the victims of this multi-billion dollar fraud their day in court -- to deny those who invested in WorldCom, Inc. ("WorldCom" or the "Company") the opportunity to fully illuminate in a public forum what occurred at WorldCom and why, and to show how those who participated in, knew of, or recklessly and/or negligently disregarded what took place at the Company should be made to answer to the victim investors. As described more fully below, these challenges to the Complaint are unavailing, and the motions to dismiss should be denied in their entirety.

The exception referred to above is a substantial concession by the Director Defendants. They have not challenged Count I, and thereby concede that the Complaint adequately pleads that they violated Section 11 of the Securities Act of 1933 ("Securities Act") in connection with WorldCom bond offerings in May 2000 and May 2001 (together, the "Offerings"). That claim -- and this litigation -- will therefore proceed to discovery, notwithstanding the five motions to dismiss.

With regard to the other claims against them, the Director Defendants assert various legal arguments about why those claims should be extinguished at the pleading stage. None of those

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resolved. Despite being served on November 27, 2002, Defendant Buford Yates, Jr. has not yet filed an appearance in this action or responded to the Complaint. WorldCom is not a defendant in these proceedings because it filed for bankruptcy protection on July 21, 2002.

arguments withstands scrutiny. They argue that Count VI, which alleges that certain of the directors violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), should be dismissed because the Complaint fails to comply with the pleading standards of the Private Securities Litigation Reform Act of 1995 ("PSLRA") and Fed. R. Civ. P. 9(b). Specifically, they contend that the Complaint improperly engages in "group pleading" rather than trace any false statement to the directors named in Count VI, and also fails to allege that they acted with scienter. As demonstrated below (Point II.B.), their arguments are without merit. The "group pleading" argument has no application here because each of the directors personally signed the registration statements and other WorldCom filings at issue. As for scienter, the Complaint amply alleges that Defendants Allen, Areen, Bobbitt and Galesi -- members of the Audit Committee specifically responsible for safeguarding the integrity of the Company's financial statements -- were, at the least, reckless, and that the conduct of Galesi and Kellett, the only other Director Defendant charged with violating Section 10(b), was tainted by "motive and opportunity" as well as recklessness. The Director Defendants also contend that WorldCom's directors should be given a pass from any responsibility as "control persons" under Section 15 of the Securities Act (Count II, in connection with the Offerings) and Section 20(a) of the Exchange Act (Count VII, in connection with the fraud claims). As explained below (Point III), the notion that this board of directors (the "Board") lacked either control or "culpable participation" in the meltdown at WorldCom is also without merit.

The Underwriter Defendants, like the Director Defendants, do not dispute that the Complaint properly alleges a Section 11 claim against them in connection with the Offerings (Count IV). Nor do they challenge the viability of the Section 12(a)(2) claim brought against them in connection with those same Offerings (Count V). Rather, they contend that these Securities Act claims must be dismissed

because this Court appointed a lead plaintiff that did not purchase bonds on the Offerings. Unfortunately for the Underwriter Defendants (and the Salomon Defendants, Andersen, and Ebbers, who adopt this argument as well), this point rests on a fundamental misapprehension of the lead plaintiff provisions of the PSLRA, which was never intended to excise from a consolidated class action claims that the lead plaintiff does not itself possess -- particularly where, as here, the consolidated complaint specifically identifies named plaintiffs who do have those claims (Point I.B.). As the Underwriter Defendants are constrained to concede, the very argument they make here was emphatically rejected in this District just a few weeks ago, when Judge Scheindlin issued her ruling on the motions to dismiss in In re Initial Pub. Offerings Sec. Litig., No. 21 MC 92, 2002 U.S. Dist. LEXIS 23823 (S.D.N.Y. Dec. 12, 2002) (hereafter, "IPO Sec. Litig."). After reviewing the history and construction of the pertinent PSLRA provisions, Judge Scheindlin observed,

> The fact that the lead plaintiff is to be selected in accordance with objective criteria that have nothing to do with the nature of the claims . . . strongly suggests the need for named plaintiffs in addition to any lead plaintiff. Courts are constrained to choose a lead plaintiff who has, among other things, the largest financial stake in the outcome of the case. It stands to reason that in many cases, the instant cases included, the plaintiff with the largest financial interest may not have standing to sue on all causes of action. There is nothing to suggest that, in those cases, Congress intended that plaintiffs must file an entirely separate class action lawsuit when, in any other context, a subclass would suffice.

Id. at *14 (citing Newby v. Enron Corp. (In re Enron Corp., Securities Litigation), 206 F.R.D. 427, 451 (S.D. Tex. 2002) (hereafter, "Enron Sec. Litig.").

The standing arguments proffered by the Underwriter Defendants against the plaintiffs who did purchase bonds in the Offerings are also ill-founded. As explained below (Point I.C.), the County of Fresno ("Fresno"), the Fresno County Employees Retirement Association ("FCERA"), and HGK

Asset Management, Inc. ("HGK") (together, the "Named Plaintiffs") do not suffer from any of the various incapacities alleged by these Defendants. Accordingly, Counts IV and V must be sustained.

In the course of its investigation into the collapse of WorldCom, the NYSCRF concluded that one of the Underwriter Defendants, Salomon, was in position well before the Offerings to know that WorldCom's registration statements did not reflect the Company's actual condition. As recounted more fully below (Point II.D.), no one on Wall Street was better qualified to see through financial chicanery in a telecommunications company than Salomon's superstar analyst, Jack Grubman -- and no one had his finger more firmly on the fiscal pulse of WorldCom. Former senior Salomon insiders -- including one source who had routine contact with Grubman and senior officers at WorldCom (including CFO Sullivan) -- confirmed that Grubman's access to Sullivan and Ebbers (and vice versa) was extraordinary. More ominously, the NYSCRF learned that Grubman had abandoned the long-time analytical model he had used to value telecommunications companies at just the point in time when continued use of that model would have flagged WorldCom's fading business for the investing public (and in particular, purchasers in the May 2000 Offering). Significantly, when Grubman changed models, he did it for one company only -- WorldCom -- yet continued to use his long-time model for the other companies he covered for another two years.

Further, in addition to gathering additional evidence concerning two issues drawing widespread scrutiny as the WorldCom scandal broke -- Grubman's incessant touting of the Company in his analyst reports and Salomon's campaign to deliver lucrative shares in "hot" IPOs to senior WorldCom decision makers -- Lead Plaintiff also discovered the previously undisclosed fact that Salomon's corporate sibling, The Travelers Insurance Company ("Travelers"), loaned several hundred million dollars to an

Ebbers-controlled entity shortly before Salomon was selected to underwrite the $5 billion Offering in May 2000.

None of these facts -- or the fact that Grubman's $20 million salary was directly affected by how much business the Company he was praising would send to Salomon -- had been disclosed to the investing public. In light of Salomon's reckless disregard of financial information Grubman was uniquely positioned to access and analyze, and because Salomon failed to inform investors of its deeply conflicted relationship with senior WorldCom executives, the Complaint alleges that this particular underwriter is liable to bond purchasers not only under Sections 11 and 12(a)(2) of the Securities Act (Counts IV and V, discussed above), but also -- together with Grubman -- for fraud under Section 10(b) of the Exchange Act (Count IX). The fraudulent statements and omissions that infected the registration statements for the Offerings also pervaded Grubman's analyst reports, which thus form the basis for a Section 10(b) claim for open-market stock and bond purchasers (Count X).

Salomon and Grubman move to dismiss Counts IX and X on three primary grounds: (1) the Complaint fails to allege that anyone at Salomon "knew" of the fraud at WorldCom; (2) the Complaint fails to plead loss causation; and (3) Salomon had no duty to disclose to investors any of the highly material conflicts described at length in the Complaint. As demonstrated below (Point II.D.), these arguments are without merit.

With respect to the accounting fraud, Salomon and Grubman fail to acknowledge that it is sufficient if the Complaint alleges that they recklessly disregarded evidence that fraud was afoot, and the Complaint amply demonstrates that Grubman and Salomon did so. The Complaint also shows that the false and misleading statements in both the registration statements and Grubman's analyst reports contributed to the investors' losses because those statements helped artificially boost the prices of

WorldCom's stock and bonds. Moreover, contrary to what the Salomon Defendants contend, the conflicts between Grubman, Salomon and WorldCom did in fact surface several months before WorldCom filed for bankruptcy -- and those disclosures had a dramatic impact on the price of WorldCom securities. Finally, both the statutory framework and well-settled securities jurisprudence required Salomon to disclose the various conflicts described in the Complaint.[4]

Andersen's challenge to Count III, which charges it with violating Section 11 in connection with the Offerings, is limited to adopting the Underwriter Defendants' argument that Securities Act claims may not be prosecuted in this consolidated class action because the NYSCRF is the Lead Plaintiff. Andersen does not dispute that the Complaint properly pleads a Section 11 claim against it and, as mentioned above, the standing argument it incorporates by reference fails. With regard to the Section 10(b) claim against them (Count VIII), Andersen and its audit partner on the WorldCom account, Dick, suggest that, if only the Court would (a) ignore the fact that their audits missed at least $9 billion in fictitious earnings (over <u>fifteen times</u> the amount restated in Enron); (b) a host of "red flags" concerning the accounting fraud; and (c) an e-mail which confirms that Andersen was on <u>actual notice</u> of fraudulent accounting at WorldCom more than two years -- and $17 billion in bond sales -- before the scandal broke, then there would be no basis to keep them in this case. As demonstrated in Point II.C., Andersen's arguments that it should be dismissed from this case are meritless.

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[4] The Salomon Defendants' sole challenge to the Section 20(a) "control person" claim against Citigroup and Salomon (Count XI) is that Plaintiffs have failed to plead an underlying violation of the securities laws in either Count IX or X. They do not dispute that, if these violations were adequately pled (as they were), Citigroup is a control person of Salomon and Salomon is, in turn, a control person of Grubman (or at least it was, until Grubman resigned and subsequently agreed to a lifetime ban from the securities industry).

Finally, WorldCom's founder and long-time CEO Ebbers argues that, as a matter of law, he cannot be held liable for the $9 billion fraud at WorldCom on the basis of the allegations in the Complaint. Ebbers' argument is essentially that the fraud implemented by his hand-picked CFO may not be ascribed to him, even though Sullivan told investigators that Ebbers was fully aware that hundreds of millions of dollars of expenses had been moved into capital expenditures accounts to inflate the Company's earnings. Ebbers' argument runs directly contrary to the well-established principle that allegations in a complaint are to be viewed most favorably to the plaintiff (Point II.A.). His related argument that the facts alleged in this Complaint are somehow not credible or reliable must likewise be rejected. Indeed, when offered the opportunity to put his own credibility on the line and explain to Congress last summer how he could have been oblivious to the fact that his management team was orchestrating the largest corporate fraud in history, Ebbers invoked the Fifth Amendment.

As shown below, the Complaint amply satisfies the requirements of the Federal Rules of Civil Procedure and the PSLRA. The motions to dismiss should be denied.

STATEMENT OF FACTS[5]

The Fraud at WorldCom

By now, the world is painfully aware of the fraud that engulfed WorldCom, bringing what was once the second largest telecommunications company in the world to its knees. Between early 1999 and June 2002, WorldCom overstated its publicly reported earnings by an almost incomprehensible $9

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[5] On a Rule 12(b)(6) motion to dismiss, the Court must presume that the Complaint's allegations are true and give Lead Plaintiff the benefit of every favorable inference that can be drawn from its allegations. See Taylor v. Vermont Dept. of Educ., 313 F.3d 768, 776 (2d Cir. 2002); Cromer Fin. Ltd. v. Berger, 137 F. Supp. 2d 452, 468 (S.D.N.Y. 2001) (Cote, J.).

billion. ¶ 5.[6] The accounting fraud, by far the largest in history, plunged the Company into bankruptcy, catapulted public outrage over duplicity within corporate America to heights never before seen, and resulted in numerous investigations, Congressional inquiries and, ultimately, the most extensive overhaul of the nation's securities laws since enactment of the Exchange Act in 1934. ¶¶ 1, 7, 8, 105, 253, 295.

What is as notable as the magnitude of the fraud is that it was accomplished through accounting gimmicks that were simple to perpetrate and, had the gatekeepers on whom the investing public relied not looked away, just as simple to uncover. Essentially, some of WorldCom's most senior officers, including its Chief Financial Officer and Controller, would sit down at the end of each quarter, compare the Company's actual financial results with the consensus estimates of Wall Street analysts and, when they determined that the actual results missed those estimates (usually by a wide margin), employ naked accounting chicanery to erase hundreds of millions of dollars of expenses, thereby engineering phony profits and ensuring that the Company would report "results" which met expectations. ¶¶ 3, 89-95, 98-101. The mechanics of the fraud were so rudimentary that a KPMG audit partner who later reviewed the

accounting manipulations at WorldCom concluded that this was "an open and shut case;" another accounting expert stated that "[t]his is basic stuff." ¶¶ 94, 318.

The admitted accounting manipulations were accomplished in two ways. First, WorldCom inflated reported income by drawing on reserves that had supposedly been established to cover

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[6] References to the paragraphs of the Complaint are cited to herein as "¶ __." As WorldCom has admitted, the Company overstated its pretax earnings by at least $209 million in 1999; $3.257 billion in 2000; $3.382 billion in 2001; and $835 million in the first quarter of 2002. ¶ 322. There are reports that an additional $2 billion in restatements may be forthcoming. ¶ 5. The Company has not filed restated financial statements or quantified the final size of the restatement, however, and the various investigations of the fraud are continuing. Thus, it is quite possible, if not likely, that the restatement will be even larger.

"merger-related" costs. ¶ 84. Specifically, by no later than the third quarter of 2000, WorldCom's senior management began to instruct employees to make unsupported journal entries in the Company's general ledger which credited, or reduced, the Company's line cost expenses by an amount necessary to meet estimates.[7] ¶¶ 3, 90. These instructions were made at the end of the quarter, after WorldCom's books for the quarter had closed, when WorldCom knew the precise amount by which its earnings would miss Wall Street estimates. ¶ 3. Then, to make these entries balance on WorldCom's general ledger, the Company's CFO, Sullivan, ordered that various reserve accounts be debited in amounts equivalent to the line cost credits. ¶ 91(c). Significantly, there was no documentation to support these massive "adjustments," nor was there any legitimate business rationale for these machinations. ¶ 3. Instead, the adjustments were made to camouflage the marked deterioration in WorldCom's business and to make it appear that WorldCom was a strong, profitable company, when in fact the opposite was true. ¶ 68. As WorldCom's former Controller ultimately admitted, "I was instructed on a quarterly basis by senior management to ensure that entries were made to falsify WorldCom's books to reduce WorldCom's reported actual costs and therefore to increase WorldCom's reported earnings." ¶ 3. Through these fraudulent acts, WorldCom's management improperly inflated its earnings by $1.235 billion during the third and fourth quarters of 2000 alone. ¶ 93.

As WorldCom's business continued to deteriorate, it became clear that WorldCom's merger reserves had become so depleted that management could not continue to draw upon them to cover up WorldCom's true financial condition. ¶ 94. Thus, the Company turned to a second, albeit related,

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[7] Line costs are the fees that WorldCom pays local telephone companies to carry the calls of WorldCom's customers. ¶ 88.

method of committing financial fraud to meet the Street's expectations. Beginning no later than the first quarter of 2001, WorldCom's senior management began instructing WorldCom employees to fraudulently account for line cost expenses as capital expenditures. ¶ 95(c). Again, these accounting adjustments were made without any supporting documentation or legitimate business rationale. ¶ 3. Over the next five quarters, WorldCom treated a substantial portion of its line cost expenses as "capital investments," and recorded them as an asset on the Company's balance sheet, where they would be depreciated over time, rather than being recorded as expenses, which would have had a huge and immediate adverse impact on WorldCom's reported profits. ¶ 94. This was a blatant and egregious violation of generally accepted accounting principles ("GAAP"), which specifically provide that line costs are to be accounted for as expenses, and cannot be capitalized. Id. Indeed, prior to 2000, WorldCom had always accounted for line costs, which -- as Defendants such as Grubman and the Andersen Defendants surely knew -- constituted its single biggest operating expense, as an expense and had reported line costs as a separate line item on its income statements as part of its operating expenses. ¶ 88. Through these fraudulent acts, WorldCom improperly inflated its reported income from 2001 through the first quarter of 2002 by a staggering $3.8 billion. ¶ 3.

On June 25, 2002, WorldCom issued a press release announcing that an internal audit had discovered approximately $3.8 billion of improperly reported earnings for 2001 and the first quarter of 2002 and that it would restate its financial statements for this time period. ¶ 104. Immediately after this announcement, numerous governmental entities launched investigations into WorldCom's financial statements. ¶ 105. The Securities and Exchange Commission ("SEC") filed its civil fraud complaint against WorldCom (the "SEC Complaint") the very next day. ¶ 7. The President of the United States called the stunning disclosure "outrageous," and the Chairman of the SEC labeled it "fraud, not a

mistake." Id. On July 8, 2002, Ebbers and Sullivan were summoned to testify before the House Committee on Financial Services where, in front of the nation, they refused to offer any explanation for what had occurred at WorldCom, instead invoking their Fifth Amendment rights against self-incrimination. ¶¶ 7, 106. Two weeks later, WorldCom filed the biggest bankruptcy in history. ¶ 6.

As was subsequently disclosed, the fraud began long before the third quarter of 2000. In fact, internal WorldCom e-mails show that WorldCom senior management was cooking the books by improperly recording line cost expenses by no later than the first quarter of 2000. ¶ 96. Moreover, while the final restatement has not been announced, the Company has since admitted that its earnings for 1999 were materially overstated by hundreds of millions of dollars, and that as a result the Company will be required to restate its results for 1999 in addition to those for 2000, 2001 and the first quarter of 2002.

Sullivan was indicted in this District for securities fraud and related charges on August 28, 2002. ¶ 8. Four other senior WorldCom employees have pled guilty to multiple felonies, including securities fraud and conspiracy to commit securities fraud. In pleading guilty, each of these employees admitted that the fraud had been committed at the behest of WorldCom's senior management. Id.

The Fraud Occurred Because of a Corporate Culture That Condoned Fraud, and Because the Gatekeepers Were Complicit

A fraud this large and this brazen does not happen overnight, and it does not occur in a vacuum. Rather, it occurred because WorldCom's corporate culture condoned subterfuge and because the gatekeepers -- the auditors, the Board, and the underwriters -- were either complicit or asleep at the switch. As The Washington Post reported following an extensive investigation of the fraud, there was

rampant "internal chicanery and corruption" at WorldCom in the years preceding the restatement. ¶ 337(a).

The Washington Post determined that WorldCom employees routinely booked orders for services and equipment to meet revenue targets regardless of whether these items had actually been ordered and that employees often falsified sales to boost their commissions. Id. Moreover, for years, WorldCom had fraudulently used "cookie jar" merger reserves to artificially inflate earnings. The Company's growth was predicated on aggressively pursuing acquisitions, and by 1998, WorldCom had acquired more than sixty companies valued at more than $70 billion. ¶ 80. With each acquisition, WorldCom would take huge charges to account for merger-related costs. ¶ 83. However, WorldCom would include in the charges the costs of the acquired company's expenses in the future, so that they would not have to be recorded in the periods in which they were actually incurred. Id. WorldCom would also tap into these reserves when necessary to boost income. ¶ 84. The fact that WorldCom was engaging in these machinations was well known at the Company; in fact, in early 2000 Ebbers assured WorldCom employees that "we won't have to worry about earnings for years," precisely because he knew the Company would be able to make up for any shortfall in its results by dipping into its reserves when necessary. ¶ 296(b).

Ebbers was wrong. By late 1999 and early 2000, the fundamentals in the telecommunications industry had started to deteriorate markedly, at the same time that WorldCom's fixed expenses in the form of line costs were increasing. ¶¶ 82, 275. WorldCom's senior executives recognized that business was rapidly deteriorating, and its improper accounting began to attract attention within some quarters of the Company. ¶ 89. In March 2000 -- two years before the fraud was disclosed and before some $17 billion in WorldCom bonds were sold to the unsuspecting public -- Steven Brabbs,

then WorldCom's Director of International Finance & Control, sent an e-mail to WorldCom executives and Andersen, the Company's purportedly independent auditor, notifying them that, after the books for the International Division had closed for the first quarter of 2000, an entry had been made on the books that reduced the International Division's line cost expenses by $33.6 million. ¶ 96(a). When Brabbs questioned the entry, he discovered that Sullivan had directed the entry be made, but Brabbs never received any justification for this accounting treatment. Id. Shortly thereafter, in April 2000, Brabbs reviewed his division's first quarter results and the questionable transfer with a "high level" Andersen UK partner in the United Kingdom. ¶ 96(b). Brabbs told the Andersen UK partner that the increase in margin trend as a result of the fraudulent transfer was "obvious" and urged him to consult with Andersen in the United States. Id. Shortly thereafter, Brabbs received an e-mail from Myers, who expressed anger that Brabbs had raised the issue with Andersen. ¶ 96(c). The entry was never corrected; to the contrary, to try to hide the adjustment, WorldCom established a fictitious entity and placed the costs on the books of that sham entity, where it remained until the fraud was disclosed more than two years later. ¶ 96(d).

The first gatekeeper had thus become complicit in the fraud. As WorldCom's independent auditor, Andersen was required to exercise professional skepticism in conducting the WorldCom audits. Despite having actual knowledge that WorldCom's management was fraudulently capitalizing line costs that should have been treated as regular operating expenses, none of the Andersen entities ever investigated WorldCom's practices of accounting for these line costs or corrected the accounting treatment. ¶¶ 96, 317. Indeed, these phony journal entries remained on WorldCom's books until after Andersen was replaced as WorldCom's auditor in May 2002. ¶ 317. Had the Andersen entities ever brought the required level of "professional skepticism" to a review of WorldCom's general ledger, they

would have seen billions of dollars worth of entries that had no supporting documentation. ¶ 432. Instead, they turned a blind eye and allowed the fraud to continue.

As 2000 continued, the telecommunications industry continued to deteriorate. ¶ 88. By July 2000, WorldCom's most senior officers were well aware that WorldCom's revenues were falling precipitously and that this decline "created a substantial risk that WorldCom's publicly reported income would fail to meet the expectations of Wall Street analysts." ¶ 89 (quoting SEC Complaint). In October 2000, only days before the Company was to announce its third quarter results, Sullivan told Sidgmore -- then the Vice Chairman of the Board -- that WorldCom was in a "really scary" situation of escalating costs and declining revenue. ¶ 338. Sidgmore responded "Wow! I had no idea that the revenue growth had deteriorated that much," and added that "it's going to take some pretty fancy explaining." Id. (quoting an e-mail described by The Washington Post). Sullivan agreed, and told Sidgmore that, to make sure WorldCom would meet its earnings targets for the third quarter, Sullivan would make some accounting manipulations, reclassifying what should have been booked as revenue as "cost reductions." Id. As a result, on October 26, 2000, WorldCom reported results that, while falling short of revenue estimates, nonetheless met or exceeded analysts' earnings expectations. ¶ 339. Once again, another supposed gatekeeper -- the Vice Chairman of the Board -- had acquiesced to Sullivan's manipulations.

Despite the accounting machinations, WorldCom's business continued to fade, and Ebbers and his colleagues became increasingly desperate. In January 2001, Ebbers had dinner with, among others, Sullivan, Myers, Ron Beaumont (WorldCom's Chief Operating Officer), and another senior WorldCom employee, Tom Bosley, to discuss the state of the Company's business. ¶ 99. As later recounted in a Myers e-mail, at that dinner, with Ebbers looking on, Bosley volunteered "to do

whatever necessary" to get WorldCom's margins back in line. ¶ 99(b). Sullivan later instructed Myers to tell Bosley that "he needs to get to work now" on ensuring the fictitious numbers were input as soon as possible. ¶ 99. At the same time, WorldCom's internal audit department was instructed not to do any auditing or review of the Company's financial statements. ¶ 102. Almost simultaneously, WorldCom began to fraudulently capitalize billions of dollars of line cost expenses, radically inflating earnings. ¶ 107.

Despite various Defendants' efforts to inflate the Company's financial results, WorldCom's stock price had fallen from a Class Period[8] high of $65 (¶ 6) to $27 by the end of September 2000 (¶ 299). As a result, Ebbers, who had secured huge loans using his WorldCom stock as collateral, faced margin calls from his lenders, which would have required him to sell material amounts of his WorldCom stock. ¶ 297(a). Accordingly, from September through December 2000, the Board "loaned" Ebbers $100 million of the shareholders' money and guaranteed an additional $100 million of Ebbers' loans from Bank of America. ¶ 297(c). Since these corporate loans were also secured by Ebbers' WorldCom stock, Ebbers and every member of the Board knew that, if WorldCom did not make its numbers, WorldCom's stock would collapse and its high-profile CEO would face financial ruin. ¶ 297. As The Wall Street Journal later reported, the Board and WorldCom's senior management felt enormous pressure to report strong earnings, a "horrible, miserable environment because the CEO was margined out of his mind." Id.

Yet another gatekeeper, the Audit Committee of the Board, composed of Defendants Max Bobbitt, Judith Areen, James Allen, and Francesco Galesi, also failed to discharge its heightened

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[8] As defined in the Complaint, the Class Period encompasses the period between April 29, 1999 and June 25, 2002.

responsibilities to investors. By the end of 2000, WorldCom had taken over $1.2 billion from merger reserves with no supporting documentation, yet the Audit Committee failed to question this clear fraud. ¶¶ 91-93, 325, 380. The Audit Committee (and the rest of the Board) similarly failed to question the massive re-classifications of line cost expenses as capital expenditures in 2001 and 2002, notwithstanding that such capital expenditures had not been approved by the Board. ¶¶ 383-85; see also ¶ 94.

Further, although the Audit Committee was specifically responsible for ensuring that WorldCom had adequate internal controls to deter management fraud, the Audit Committee's own notes reveal that, by no later than June 2001, it was aware of serious problems with the internal controls at WorldCom, yet did nothing meaningful to address these deficiencies. ¶ 314. For example, the Audit Committee was informed that sales personnel throughout the Company were shifting accounts from one billing system to another to create fictitious sales, which allowed them to receive commissions on these purported sales. Id. The Audit Committee also knew that WorldCom employees were routinely booking sales when customers had not even ordered the product, solely to meet revenue targets. Id. The Audit Committee -- those members of the Board specifically charged with ensuring the integrity of the financial statements -- knew that there were material weaknesses in WorldCom's internal controls; knew that the Company's business was deteriorating, but that somehow the Company was continuing to report strong earnings; and knew that Ebbers was under enormous pressure to make sure WorldCom's stock did not drop. The Audit Committee did nothing. As was ultimately revealed, and as might be imagined at a company where a fraud of this magnitude occurred, WorldCom had no meaningful internal fraud controls. ¶ 314.

Grubman and the Banks

The final gatekeeper -- the Underwriter Defendants who marketed billions of dollars in WorldCom bonds -- also failed the investing public. In May 2000 and May 2001, WorldCom borrowed a staggering $17 billion from investors who purchased bonds issued by the Company and underwritten by the Underwriter Defendants. ¶¶ 196, 203. The May 2001 Offering alone, for nearly $12 billion, was by far the largest corporate bond offering in the history of the financial markets. ¶ 203. The size and prestige of each of these deals -- and the lucrative investment banking fees to be pocketed by the underwriters -- attracted some of Wall Street's largest and most prestigious investment banks, including Salomon and J.P. Morgan Chase, who served as co-lead underwriters in each of the Offerings. ¶ 198. The investing public looked to the expertise, experience and financial savvy of the Underwriter Defendants to conduct the reasonable due diligence investigation that the securities laws required them to do.

The Complaint further demonstrates that one of the lead underwriters for the Offerings was uniquely positioned to detect that the financial state of affairs at WorldCom was not what it seemed, yet took steps to camouflage WorldCom's deteriorating financial condition in order to reap huge fees from its relationship with WorldCom and its senior officers. At all relevant times, Grubman was Salomon's key telecommunications analyst -- the most influential telecom analyst on Wall Street -- and was renowned as the one man in that sector who could make or break a company. ¶ 236. Grubman, whom Salomon represented to be an "independent" research analyst, issued dozens of analyst reports on WorldCom, invariably extolling the virtues of the Company and its management. ¶ 249. Grubman urged investors to "load up the truck" with WorldCom stock, pronounced Ebbers a "visionary," and

even went so far as to ridicule investors who did not buy stock in WorldCom, telling them they should "seriously think about another vocation." ¶ 258.

Far from being an independent analyst, however, Grubman was a de facto WorldCom insider. ¶ 246. In effect, Grubman functioned as WorldCom's financial advisor. ¶¶ 250, 271. He attended important meetings of the Board and fostered close personal relationships with WorldCom's executives, Ebbers in particular. ¶ 245. Grubman arranged for one of his "boys" at Salomon to handle a significant brokerage account for Ebbers. ¶ 280. Grubman played a role in setting up loans for several hundred million dollars that Salomon's corporate sibling, Travelers, made to an Ebbers-controlled entity just before WorldCom was to select the underwriters for the May 2000 Offering. ¶¶ 279-85. Grubman displayed a breathtaking familiarity with the financial facts and figures at WorldCom -- and was able to publish voluminous reports analyzing Company releases immediately on the heels of WorldCom releasing those figures to the public at large. ¶ 274. Grubman's relationship with WorldCom's senior financial officers was a two-way street; for example, Sullivan was aware of Grubman's decision to change his valuation model for WorldCom at or before the time Grubman informed the Salomon retail sales force of the change, and was pleased with that change. ¶ 277.

Through Grubman's favored status, and given his vaunted grasp of the financial details of the then-declining telecommunications sector, Grubman either knew or recklessly disregarded that the Company was a house of cards about to topple. As noted above, as WorldCom's financial situation was rapidly deteriorating, Grubman changed his method of analyzing WorldCom, which helped to hide this fact from investors. ¶¶ 275-78. This was a hallmark of Grubman's analyst reports about WorldCom: whenever a negative event occurred that Grubman knew the market would view as an adverse development for WorldCom, Grubman would issue a report either neutralizing the event or

recasting it as positive news. ¶ 263. For example, Grubman told investors that massive layoffs at WorldCom were a sign that the management team was properly focused on "achieving results," that the national tragedy of September 11 was an opportunity for the Company, that the failure of the Sprint merger was a positive event (even though he had earlier touted the deal), and that the SEC's inquiry into WorldCom's accounting was "general" and "boilerplate." ¶¶ 261, 263, 267, 269. However, each of the analyst reports was materially false and misleading, made more so by Grubman's knowledge of WorldCom's deteriorating financial condition (which Grubman, like WorldCom's officers, directors and auditors, helped hide from the investing public) and, as discussed below, by the failure to disclose the material conflicts of interest that existed between and among WorldCom, Ebbers, Salomon and Grubman.

Unbeknownst to investors, Salomon and WorldCom entered into an illicit, quid pro quo relationship in which, in order to obtain WorldCom's lucrative investment banking business, Salomon and Grubman agreed to provide WorldCom's most senior officers with millions of dollars worth of de facto kickbacks, hundreds of millions of dollars in loans, and effusive analyst reports that they knew full well would inflate the price of WorldCom securities. ¶¶ 13, 222. This clandestine arrangement was likened by New York State Attorney General Eliot Spitzer to "commercial bribery." ¶ 222.

To attract WorldCom as a client, Salomon provided Ebbers, Sullivan and at least one Director Defendant (Kellett) with millions of dollars of risk-free shares of "hot" initial public offerings, which Salomon knew would put easy money into the pockets of key decision-makers at WorldCom. ¶ 222. While Salomon provided this remuneration to a number of executives in the telecom industry, no one benefitted like WorldCom and, in particular, Ebbers. ¶ 229. On at least twenty-one occasions, Salomon allocated to Ebbers hot IPO shares, which Ebbers sold for a handsome profit of $11.5

million. ¶ 228. Salomon often allocated Ebbers significant percentages of Salomon's total retail allotment. ¶ 231. For example, Ebbers was awarded two-thirds of Salomon's entire retail allocation of McLeod's initial public offering -- 200,000 shares valued at $20 million. ¶ 231. Id. Ebbers also received 10.5% of Salomon's entire allotment of Nextlink Communication and 12.4% of Qwest. Id.

Ebbers was not the only WorldCom executive to benefit from Salomon's largesse. Sullivan received at least 32,300 hot IPO shares in nine companies, and Kellett -- Ebbers' close friend who served as Chairman of the Compensation Committee of the Board -- received at least 31,550 hot IPO shares from Salomon. ¶ 228. Once the details of this scheme were brought to light, the spokesperson for the House Committee on Financial Services stated that it was an "inescapable conclusion that the [IPO] shares were offered in order to leverage investment banking business." ¶ 226.

The Complaint describes how it was, at times, difficult for Salomon to satiate WorldCom management's desire for hot IPO shares. After Sullivan was given 2,000 shares of the Rhythms NetConnection IPO in April 1999, he called a Salomon broker to insist that he receive more. ¶¶ 291-92. To pacify Sullivan, Salomon gave him 5,000 additional shares after the stock had already started trading in the secondary market. ¶ 292. Moreover, Ebbers often shared his profits on the IPOs with Sullivan, providing Sullivan with a check drawn on Ebbers' personal checking account. ¶ 293. Salomon processed four to seven such checks for Sullivan -- for six-or seven-figure amounts -- and Sullivan told his broker that these checks were a "bonus" from Ebbers. Id. Grubman was the gatekeeper to the exclusive and profitable club of those who obtained these shares -- he helped decide who would receive shares of any given public offering, and how big an allotment they would receive. ¶ 239.

As noted above, the NYSCRF's investigation uncovered another prong of this nefarious quid pro quo relationship. Unbeknownst to investors, in late 1999, Salomon and Grubman arranged for Ebbers to receive a half billion dollar loan from Travelers, which is, like Salomon, a unit of Defendant Citigroup. ¶ 281. This loan was made only a few months before WorldCom was to select the lead underwriters on the $5 billion bond offering in May 2000. Id. To conceal the identity of the borrower, the loan was not made to Ebbers himself, but to a shell corporation called Joshua Timberlands LLC, which Ebbers created for the purpose of receiving the loan proceeds. Id. Ebbers then took this money and bought approximately half a million acres of timberland of questionable value in three southern states. Id. Sources say that Grubman likely received a "finder's fee" for brokering this valuable deal. ¶ 289.

As the third and final prong of the scheme, Salomon agreed to continue providing WorldCom with the currency that every telecommunications company coveted -- glowing analyst reports issued by Grubman. These reports were critical to artificially inflating the price of WorldCom securities. ¶ 256.

The "trifecta" offered by Salomon -- hot IPO shares, hundreds of millions of dollars in personal loans, and consistently bullish analyst reports -- worked, at least from Salomon's perspective. As noted above, shortly after Ebbers received a half billion dollar loan from Citigroup's Travelers, Citigroup's Salomon landed the choice spot as co-lead underwriter for the two Offerings at issue in this litigation. ¶ 12. All told, between October 1997 and February 2002, WorldCom retained Salomon for almost two dozen investment banking deals that generated more than $107 million in fees for Salomon. ¶ 45. For that period, the fees generated by this one client alone accounted for more than 10% of the investment banking fees Salomon received from services it provided to the entire telecom sector. ¶¶ 11, 221. Further, although Grubman consistently and stridently told investors to buy every share they

could of WorldCom, he never informed them that his compensation -- approximately $20 million per year (¶¶ 11,13) -- depended on whether they took his advice, or that his "independent" recommendation had been purchased as part of an investment banking package of services that had been marketed to WorldCom. ¶ 273.

These facts -- and the material conflicts of interest they created -- were well known to Salomon and Citigroup. Indeed, even as Salomon represented to the investing public that Grubman was an independent analyst, it was widely acknowledged within Salomon that Grubman was not an analyst, but an investment banker. ¶ 243. Grubman's compensation depended on the amount of investment banking business he generated for Salomon. ¶¶ 11, 13. In 2001, for example, Grubman justified his income by listing on his personal evaluation ninety-seven investment banking transactions in which he was involved, which generated total investment banking revenues of $166 million. ¶ 244. When Grubman attended Ebbers' wedding in 1999, he billed the costs of the trip to Salomon's investment banking division, not to the research department. ¶ 246.

By December 2000, senior Salomon officers were privately admitting that there was "legitimate concern" about the objectivity of their analysts, a "rising issue of research integrity," and a "basic inherent conflict" between the research and investment banking departments. ¶ 234. In February 2001, the global head of Salomon's retail stock selling division proclaimed Salomon's research "basically worthless" because of the rampant conflicts of interest. Id. Nevertheless, Salomon continued to allow Grubman to churn out report after report on WorldCom, knowing full well that investors were relying on those reports, but too attracted by the prospect of even more investment banking fees to have him do otherwise.

Grubman continued to push WorldCom's stock until he realized that he could not maintain the charade any longer. Grubman maintained a "buy" recommendation on WorldCom until April 21, 2002, when the stock was trading at only $6 per share and had lost more than 90% of its value ($180 billion in market cap) from its Class Period high. On that day, Grubman downgraded the stock to "Neutral." ¶ 270. Even then, with WorldCom's stock at historic lows, the market took note of what Grubman had to say. Upon his downgrade the price of WorldCom stock dropped 43% over the next two trading days.

Even before WorldCom announced on June 25, 2002 that it would restate its financial statements, numerous governmental entities had launched investigations into the conflicts of interest in Salomon's research and investment banking. On April 12, 2002, The Wall Street Journal reported that New York Attorney General Spitzer, who for months had been investigating such conflicts at Merrill Lynch & Co., had turned his sights to Salomon and Grubman, issuing a subpoena for documents and e-mails related to Grubman's research. On April 25, 2002, Spitzer announced a formal investigation of Salomon, and one day later the SEC announced that it too had opened a "formal inquiry" into research practices at Salomon and other large securities firms. By September 30, 2002, Spitzer had uncovered enough evidence of wrongdoing by Ebbers and executives at other telecommunication companies with respect to the allocation of hot IPO shares that he filed a civil suit in New York State Supreme Court seeking to recover the profits these executives realized from the sale of those shares. ¶ 228. That complaint revealed numerous internal e-mails authored by Grubman, in which he privately derided a number of telecommunications companies on which he publicly maintained "buy" and "strong buy" recommendations. ¶ 240. In fact, Grubman referred to one such company as a "pig," and in another

e-mail admitted that he maintained inflated ratings on companies because he received "huge pushback from his investment banking colleagues at Salomon."

Grubman resigned his position on August 15, 2002, in the midst of a national controversy over the WorldCom scandal. ¶ 236. Salomon -- recognizing the benefits Grubman had generated for the firm -- rewarded him with a $32 million severance package and forgave a $19 million loan. ¶ 253. Since the Complaint was filed, Grubman has agreed to a lifetime ban from the securities industry.

Although the dust has not yet settled from the collapse of WorldCom, this fraud has already had profound effects on the nation. WorldCom, once the juggernaut of the telecommunications industry, filed for the largest bankruptcy in U.S. history, Congress passed sweeping securities laws reforms and, most importantly, unsuspecting investors lost billions of dollars. ¶¶ 240-42.

ARGUMENT

At this stage in the proceedings, the Court may dismiss the Complaint "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." Hishon v. King & Spaulding, 467 U.S. 69, 73 (1984) (citation omitted); see also In re Scholastic Corp. Sec. Litig., 252 F.3d 63, 69 (2d Cir. 2001). "A pleading is not a trial and plaintiffs are not required to marshal their evidence and sustain a verdict at this stage." Gabriel Capital, L.P. v. Natwest Fin., Inc., 122 F. Supp. 2d 407, 411 (S.D.N.Y. 2000). The Complaint must be read "as a whole" in determining whether it states a claim for which relief may be granted. Yoder v. Orthomolecular Nutrition Inst., Inc., 751 F.2d 555, 562 (2d Cir. 1985); Scholastic, Inc. v. Stouffer, 124 F. Supp. 2d 836, 841 (S.D.N.Y. 2000).

Applying these well-settled principles here, each of the challenges to the Complaint fails.

POINT I

THE COMPLAINT STATES CLAIMS UNDER SECTIONS 11 AND 12(a)(2) OF THE SECURITIES ACT

Under Section 11 of the Securities Act, purchasers of registered securities may sue an issuer, its directors, every underwriter of such security, and any person who signs the corresponding registration statement, if the registration statement contains a material misstatement or omission. See 15 U.S.C. § 77k(a); Milman v. Box Hill Sys. Corp., 72 F. Supp. 2d 220, 227-28 (S.D.N.Y. 1999). Section 12(a)(2) of the Securities Act imposes liability upon any person who offers or sells a security by means of a prospectus that contains a material misstatement or omission. See 15 U.S.C. § 77*l*(a)(2); Milman, 72 F. Supp. 2d at 228. Scienter is not an element of a Section 11 or Section 12(a)(2) claim. See Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) (holding that the pleading burden for such claims is "relatively minimal" and that "[i]f a plaintiff purchased a security pursuant to a registration statement, he need only show a material misstatement or omission to establish his prima facie case"). In this case, no one disputes that the registration statements and prospectuses issued in connection with the May 2000 and May 2001 Offerings contained untrue statements of material fact and omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading.

The Complaint names the following as having violated Section 11 with respect to the Offerings: the Director Defendants and Ebbers, each of whom signed the registration statements (Count I); Andersen, which authorized the incorporation of its audit opinions into the registration statements (Count III); and the Underwriter Defendants, each of whom underwrote one or both of the Offerings

(Count IV). The Complaint also alleges that the Underwriter Defendants violated Section 12(a)(2) in connection with the prospectuses they distributed to investors during the Offerings (Count V).[9]

A. With One Exception, All of the Section 11 Defendants Concede That the Complaint Adequately Pleads the Elements of a Section 11 Claim

None of the Defendants named in Counts I, III, and IV, save Ebbers, disputes that the Complaint adequately states claims against them under Section 11. The Director Defendants make no challenge whatsoever to Count I, thereby conceding its adequacy. The Underwriter Defendants seek to dismiss Count IV, but not on the ground that it fails to state a Section 11 claim against them. Rather, they make the technical (and as discussed in the next section, unavailing) argument that neither this claim, nor the Section 12(a)(2) claim, can be asserted in this litigation because the Court-appointed Lead Plaintiff did not purchase in either of the Offerings.[10]

Only Ebbers argues that there is some pleading defect to the Section 11 claim. He contends that Count I fails as to him because it does not comply with Fed. R. Civ. P. 9(b), which requires plaintiffs to plead fraud with particularity. Ebbers Br. at 39.[11] Ebbers overreaches. Section 11 claims

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[9] The sole remaining Securities Act claim, which charges Ebbers and the Director Defendants with violations of the Section 15 "control person" provision in connection with the Offerings (Count II), is addressed in Point III below.

[10] The Salomon Defendants, Ebbers and Andersen likewise challenge the ability of the NYSCRF to bring Securities Act claims against them, but since they merely incorporate by reference the standing argument asserted by the Underwriter Defendants (Salomon Br. at 34-35; Ebbers Br. at 39; and Andersen Br. at 20), their challenges fare no better.

[11] References to "Ebbers Br." are to the Memorandum of Defendant Bernard J. Ebbers in Support of His Motion to Dismiss. References to "Andersen Br." are to the Memorandum of Law in Support of Arthur Andersen LLP's Motion to Dismiss. References to "Directors Br." are to the Memorandum of Law in Support of the WorldCom Directors' Motion to Dismiss. References to "Salomon Br." are to the Citigroup Defendants' Memorandum of Law in Support of Their Motion to Dismiss the Consolidated Amended Class Action Complaint. References to "Underwriters Br." are to the Moving Underwriter Defendants' Memorandum of Law in Support of Their Motion to Dismiss

are negligence-based, rather than fraud-based, and need not satisfy the Rule 9(b) requirement that fraud claims be stated with particularity. In recognition of the elements that a plaintiff must plead to state a Section 11 claim, ¶ 345 of the Complaint (and other paragraphs relating to the Securities Act claims) states in relevant part: "This claim does not sound in fraud, and plaintiffs do not incorporate herein any allegations of fraud in connection with this Count." As a result, plaintiffs were not required to plead their Section 11 claims as though they were fraud claims covered by Rule 9(b). See, e.g., Lone Star Ladies Inv. Club v. Schlotzsky's Inc., 238 F.3d 363, 368-69 (5th Cir. 2001); In re NationsMart Corp. Sec. Litig., 130 F.3d 309, 314-15 (8th Cir. 1997); accord In re AnnTaylor Stores Sec. Litig., 807 F. Supp. 990, 1003 (S.D.N.Y. 1992) (Motley, J.) ("Because proof of fraud is not necessary to prevail on a Section 11 claim . . . courts have long held that Rule 9(b) does not apply to a Section 11 claim. . . . The same holds true when plaintiffs have raised a separate claim for fraud under Section 10(b).") (citations omitted).[12] Accordingly, the Section 11 claims in Counts I, III, and IV must be sustained as to all Defendants named therein.

B. The Complaint Properly Asserts All Securities Act Claims on Behalf of the Class

After the news of problems at WorldCom began to break, several dozen class actions were filed in federal courts throughout the country, including nineteen cases filed in this District. Several of these actions were initiated by purchasers of WorldCom bonds who alleged, among other things, that

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Counts IV and V of the Consolidated Complaint.

[12] In any event, even if one were to apply Rule 9(b) to Count I, the Complaint more than adequately asserts facts sufficient to support the claim against Ebbers. The Complaint sets forth in detail the materially false and misleading statements and omissions that form the basis of the Section 11 claim, why those statements and omissions were false and misleading, the documents in which the statements and omissions appeared, who made the statements and failed to state the material information omitted, and the reasons the statutory defendants are liable under Section 11 for the specifically identified false statements and omissions.

various of the Underwriter Defendants had violated Sections 11 and 12(a)(2) in connection with the Offerings. Pursuant to this Court's August 15, 2002 order, and without objection from any Underwriter Defendant, all of the cases filed in this District -- including two class actions asserting Securities Act claims -- were consolidated into the present action. Order of August 15, 2002 (Nos. 02 Civ. 4990 (DLC) and 02 Civ. 5285 (DLC)). A few weeks later -- at the specific request of the Underwriter Defendants -- the Judicial Panel on Multidistrict Litigation transferred all of the class actions filed in other districts to this District for consolidation into this action, including those asserting class claims on behalf of investors who purchased bonds in the Offerings. In re WorldCom, Inc. Sec. & "ERISA" Litig., No. 1487, slip op. (J.P.M.L. Oct. 8, 2002).[13]

On August 12, 2002, acting in accordance with the lead plaintiff provisions of the PSLRA, this Court appointed the moving investor with the largest loss in the WorldCom debacle -- the NYSCRF -- as lead plaintiff to prosecute, on a consolidated basis, all of the claims that had been, or could reasonably be, brought on behalf of all of the injured WorldCom investors, including those who had purchased bonds. See Order of August 15, 2002 at ¶ 8. The Court directed the NYSCRF to file a consolidated pleading by October 11 (id. at ¶16), which it did. Fulfilling its statutory and fiduciary obligations as Lead Plaintiff, the NYSCRF included Section 11 and Section 12(a)(2) claims on behalf of bond purchasers. In doing so, the Complaint named two public pension funds (Fresno and FCERA) and a private asset management fund (HGK) as Named Plaintiffs. Fresno and HGK purchased bonds in WorldCom's May 2000 Offering. ¶¶ 20, 21. FCERA and HGK purchased bonds in the May 2001 Offering. ¶¶ 19, 21.

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[13] All told, at least seven of the actions now consolidated in this matter assert claims under Section 11 on behalf of investors who purchased bonds pursuant to the registration statements issued in connection with the Offerings. At least three of the actions assert claims under Section 12(a)(2).

The Underwriter Defendants assert that the Court must now dismiss the Section 11 and Section 12(a)(2) claims against them from this consolidated action on the ground that the party appointed by the Court as Lead Plaintiff, the NYSCRF, did not purchase the debt securities issued on those Offerings, even though Named Plaintiffs Fresno, FCERA and HGK did. Defendants' argument -- never accepted by any court -- is unavailing.

According to the Underwriter Defendants, under the PSLRA, a lead plaintiff's consolidated pleading may assert only those claims that the lead plaintiff personally possesses, notwithstanding the fact that there are other plaintiffs specifically named in the consolidated complaint who do have standing to assert those claims. In other words, these Defendants argue that the PSLRA swept aside the notion of class representatives or named plaintiffs for securities class actions -- that Congress actually intended that, if the lead plaintiff did not possess every claim that the class had, those claims would either have to be (a) asserted in a second, or perhaps third or fourth separate class action, all of which relate to the same fraud but nevertheless required a different lead plaintiff, or (b) prosecuted in one action with a multi-headed leadership structure that had as many lead plaintiffs as there were potential claims. Neither can be reconciled with principles of judicial economy or, more on point, the PSLRA that governs this very question. See Aronson v. McKesson HBOC, Inc., 79 F. Supp. 2d 1146, 1151 (N.D. Cal. 1999) ("one lead plaintiff can vigorously pursue all available causes of action against all possible defendants under all available legal theories"). Perhaps not surprisingly, this argument has never been accepted by any other court and was, in fact, decisively rejected only a few weeks ago in this District by Judge Scheindlin in IPO Sec. Litig.

In that case, defendants raised the same issue, arguing that, if a lead plaintiff were unable to assert a particular claim itself, then it could not assert that claim in a consolidated securities class action

brought on behalf of other class members who did have such a claim. The court rejected this argument, holding that "in order for a claim to be asserted on behalf of a putative class, only the named plaintiffs -- but not necessarily the lead plaintiff -- must have standing." Id. at *13 (emphasis added). As Judge Scheindlin explained:

> [T]he operative question is whether the concept of a "named plaintiff" survives in securities class actions distinct from the PSLRA-defined "lead plaintiff." It does.
>
> The purpose of the lead plaintiff section of the PSLRA was never to do away with the notion of class representatives or named plaintiffs in securities class actions. Rather, the purpose was to ensure that securities litigation was investor-driven, as opposed to lawyer-driven. See S. Rep. No. 104-98 at 4 (1995) (finding that the purpose of the PSLRA is "to empower investors so that they -- not their lawyers -- exercise primary control over private securities litigation"). Indeed, the lead plaintiff provision "is intended to permit the plaintiff to choose counsel rather than having counsel choose the plaintiff." Id. at 11. See also H.R. No. 104-369 at . . . 32-35 (1995) . . . Accordingly, the only responsibility explicitly given to lead plaintiffs by the PSLRA is the power to select and direct class counsel. See 15 U.S.C. § 78u-4(a)(3)(B)(v). Nowhere is it suggested that the concept of "lead plaintiff" was intended to be coterminous with "named plaintiffs" or "class representatives."
>
> Moreover, the fact that the lead plaintiff is to be selected in accordance with objective criteria that have nothing to do with the nature of the claims (as described above) strongly suggests the need for named plaintiffs in addition to any lead plaintiff. Courts are constrained to choose a lead plaintiff who has, among other things, the largest financial stake in the outcome of the case. It stands to reason that in many cases, the instant cases included, the plaintiff with the largest financial interest may not have standing to sue on all causes of action. There is nothing to suggest that, in those cases, Congress intended that plaintiffs must file an entirely separate class action lawsuit when, in any other context, a subclass would suffice. See Newby v. Enron Corp. (In re Enron Corp., Sec. Litig.), 206 F.R.D. 427, 451 (S.D. Tex. 2002) (refusing to certify subclass representatives as lead plaintiffs).
>
> The only other possibility -- that the court should cobble together a lead plaintiff group that has standing to sue on all possible causes of action -- has been rejected repeatedly by courts in this Circuit and undermines the purpose of the PSLRA. . . .

Id. at *14-16 (emphasis added). Accord In re Oxford Health Plans, Inc. Sec. Litig., 191 F.R.D. 369, 378, 380-81 (S.D.N.Y. 2000) ("[r]eading the PSLRA in accordance with its plain meaning, the Court

concludes that being a Lead Plaintiff under the PSLRA is not the same as being a Class Representative under Rule 23 . . . [t]he Court believes on reflection that it probably has the power to designate a Class Representative under Rule 23 who is not a Lead Plaintiff, simply because there is nothing in the statute which prevents it").

The Underwriter Defendants' argument should also be rejected for another reason. From a practical standpoint, it would spawn a multiplicity of WorldCom-related securities class actions, each involving a different security, with a different lead plaintiff, but all relating to the same fraud. The district court currently handling the Enron litigation saw the dangers of that proposition when recently considering an argument similar to the one made here:

> Taken to its logical extreme, [the] argument that each group of notes issued pursuant to a different Registration Statement and Prospectus requires a different class or subclass and separate Lead Plaintiff would fracture this litigation into hundreds of classes or subclasses and obstruct any efficient and controlled progress. . . . As the primary basis for its decision, the Court's reading of the Lead Plaintiff provisions of the PSLRA, especially § 78u-4(a)(3)(B)(ii) ('the court shall appoint the most adequate plaintiff for the consolidated actions'), leads it to conclude that at this stage the statute authorizes the appointment of one Lead Plaintiff or small cohesive group for a single class. . . . Indeed the central reasons for the consolidation of these suits are that they arise out of a common core of facts, legal issues, deal with overlapping or intertwined Defendants, named or implied, and they attack various aspects of an alleged scheme and course of conduct to defraud Enron investors and the public by artificially inflating the price of Enron securities through a number of materially false and misleading statements and omissions about the financial condition of Enron. Some complaints share claims of insider trading. Moreover, it is centrally important to the litigants on both sides and to this Court, especially because there are so many parties involved and all are entitled to equal access to the evidence, that the discovery process not disintegrate into chaos and harassment. At the same time diligent and efficient prosecution of the causes of action must be encouraged.

Enron Sec. Litig., 206 F.R.D. at 451.

As the analysis set forth above demonstrates, the course taken by this Court -- appointing the Nation's second largest public pension fund as Lead Plaintiff for all securities purchasers -- and the

Complaint filed by the NYSCRF -- asserting Exchange Act and Securities Act claims and identifying Named Plaintiffs who have standing to assert the latter -- is not only sound, but completely consistent with the PSLRA, principles of judicial economy, and the two most recent court decisions on point. Consequently, the Underwriter Defendants' argument that Counts IV and V should be dismissed simply because Lead Plaintiff did not purchase bonds in the Offerings should be rejected.

C. The Named Plaintiffs Have Standing to Assert Claims under Both Sections 11 and 12(a)(2) of the Securities Act

Turning to the Named Plaintiffs, the Underwriter Defendants argue that the Section 11 and Section 12(a)(2) claims fail "to the extent that the named plaintiffs did not buy their bonds in the offerings." Underwriters Br. at 16. But the Complaint makes clear that the Named Plaintiffs did, in fact, purchase bonds directly in the Offerings, so this argument is baseless. And if by the phrase "to the extent" the Underwriter Defendants contend that the Named Plaintiffs' after-market bond purchases do not give rise to Section 11 claims, their argument is at odds with the substantial weight of authority which holds that secondary market purchasers have standing to bring such claims.

1. Each Named Plaintiff Has Standing under Sections 11 and 12(a)(2) Because It Purchased Bonds Directly in the Offerings

The Complaint alleges that Named Plaintiff FCERA purchased 136,900 shares of WorldCom stock and $8,198,295.50 worth of WorldCom debt securities, including over $3,000,000 of Notes in the May 15, 2001 Note Offering. . . ." ¶ 19 (emphasis added). The Complaint alleges that Named Plaintiff Fresno "purchased $6,352,697.37 worth of Notes in the May 24, 2000 Note Offering." ¶ 20 (emphasis added). The Complaint alleges that Named Plaintiff HGK purchased $129,486,989 of Notes, including approximately $43,000,000 of Notes in the 2000 Offering, and over $29,000,000 in the 2001 Offering. ¶ 21 (emphasis added). Since Fresno purchased all of its Notes in the May 2000

Offering, HGK purchased over fifty percent of its Notes in the May 2000 and May 2001 Offerings, and FCERA purchased over $3 million of its Notes in the May 2001 Offering, there can be no dispute that each of the Named Plaintiffs has standing to assert claims arising under Section 11 and Section 12(a)(2). See, e.g., In re Ultrafem Sec. Litig., 91 F. Supp. 2d 678, 694 (S.D.N.Y. 2000) (plaintiffs who purchased shares in the Offering have standing pursuant to Section 12(a)(2).[14]

2. Named Plaintiffs Have Standing to Assert Section 11 Claims on Behalf of After-Market Purchasers

The Underwriter Defendants' argument that secondary market purchasers have no standing to sue under Section 11 fares no better.

The Underwriter Defendants rely on a single decision from this Circuit, In re WRT Energy Sec. Litig., Nos. 96 Civ. 3610 (JFK), 96 Civ 3611 (JFK), 1997 WL 576023 (S.D.N.Y. Sep. 15, 1997) (Keenan, J.), appeal pending, No. 02-7829 (2d Cir., filed Sep. 25, 2002), and several district court cases from other jurisdictions. Underwriters Br. at 17. Since WRT was decided, however, every judge in this District who has considered this issue has held that secondary market purchasers have standing to assert Section 11 claims.[15]

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[14] The fact that FCERA and HGK also acquired Notes in the secondary market does not deprive them of standing to assert claims arising under the Securities Act. See In re Ultrafem Sec. Litig., 91 F. Supp. 2d at 694 (plaintiffs who alleged that they purchased Ultrafem shares "pursuant to the Offering and in the after-market during the Class Period" have standing under Section 12(a)(2) because they purchased shares in the offering); see also In re Am. Bank Note Holographics Sec. Litig., 93 F. Supp. 2d 424, 436 (S.D.N.Y. 2000) (McMahon, J.) ("Because the co-lead Plaintiffs group includes those who purchased their shares directly in the IPO, the class has Section 11 standing as well as Section 12(a)(2) standing. It is therefore unnecessary to decide here whether those Plaintiffs who can 'trace' their purchases to the IPO have standing under Section 11.").

[15] See In re Turkcell Iletisim Hizmetler, A.S. Sec. Litig., 209 F.R.D. 353, 358 (S.D.N.Y. 2002) (Buchwald, J.); In re AMF Bowling Sec. Litig., 2002 U.S. Dist. LEXIS 4949 (S.D.N.Y. 2002) (Chin, J.); In re Sterling Foster & Co. Sec. Litig., 222 F. Supp. 2d 216, 246 (S.D.N.Y. 2002) (Spatt, J.); Dorchester Investors v. Peak Trends Trust, 2002 U.S. Dist. LEXIS 3067, at *19 (S.D.N.Y. Feb.

The Underwriter Defendants assert that the Supreme Court's ruling in Gustafson v. Alloyd Co., 513 U.S. 561 (1995), mandates a ruling in their favor.[16] As recognized by Judge Buchwald in Turkcell, however, every circuit court to consider the issue since Gustafson has held that aftermarket purchasers who can trace their purchases to statements made in the registration statement can sue under Section 11. Turkcell, 209 F.R.D. at 359 (citing Lee v. Ernst & Young, LLP, 294 F.3d 969, 978 (8th Cir. 2002); Joseph v. Wiles, 223 F.3d 1155, 1160 (10th Cir. 2000); Hertzberg v. Dignity Partners, 191 F.3d 1076, 1080-81 (9th Cir. 1999)).

Against this great weight of authority, the Underwriter Defendants argue that WRT is the better-reasoned decision. Underwriters Br. at 18. However, the courts in this Circuit have found that the decision Judge Sweet rendered in Adair a year later to be the far better-reasoned decision, as evidenced by the fact that no other court in this District has followed WRT. See Sterling Foster, 222 F. Supp. 2d at 246 (WRT notwithstanding, the majority of courts in this Circuit have followed the reasoning and conclusion of Judge Sweet in Adair); DeMaria v. Andersen, 153 F. Supp. 2d at 310 (Adair "has emerged as a seminal case applying Gustafson to Section 11 claims").[17]

26, 2002) (McKenna, J.); DeMaria v. Andersen, 153 F. Supp. 2d 300, 309-10 (S.D.N.Y. 2001) (Pauley, J.), appeal docketed, No. 01-7505 (2d Cir. Apr. 30, 2001); Milman v. Box Hill Sys. Corp., 192 F.R.D. 105, 109 (S.D.N.Y. 2000) (Scheindlin, J.); In re Ultrafem Sec. Litig., 91 F. Supp. 2d 678, 694 (S.D.N.Y. 2000) (Preska, J.); Salomon Smith Barney v. Asset Securitization Corp., 1999 U.S. Dist. LEXIS 19030, at *9 (S.D.N.Y. Dec. 3, 1999) (Jones, J.); Adair v. Bristol Tech. Sys., Inc., 179 F.R.D. 126, 130-33 (S.D.N.Y. 1998) (Sweet, J.). In view of this overwhelming weight of authority, it is an overstatement to assert, as the Underwriter Defendants do, that "[a]uthorities in this district . . . are split on the issue. . . ." Underwriters Br. at 18.

[16] As discussed more fully below, the Supreme Court in Gustafson held that a purchase agreement issued in connection with a private secondary transaction was not a "prospectus" for the purposes of Section 12(a)(2). 513 U.S. at 589.

[17] This issue is currently before the Second Circuit in the DeMaria v. Andersen case. See Turkcell, 209 F.R.D. at 358.

Adair rejected the very arguments put forth by the Underwriter Defendants here. Citing Barnes v. Osofsky, 373 F.2d 269 (2d Cir. 1967) (Friendly, J.), Judge Sweet observed that for more than thirty years, it has been the law in the Second Circuit that a plaintiff who can trace his or her securities to a registered offering has a cause of action under Section 11. 179 F.R.D. at 130. In Barnes, the Second Circuit concluded that a class action settlement properly limited benefits to those who could trace their purchases to the registration statement, as opposed to a broader class consisting of all holders of the issuer's securities. 373 F.2d at 272. In concluding that the class properly included those who could trace their shares to the registration statement, the court reviewed the legislative history of Section 11, including a House Report stating that Section 11 remedies were accorded to purchasers "regardless of whether they bought their securities at the time of the original offer or at some later date." Id. at 273 (quoting H.R. Rep. No. 73-85 at 22 (1933)).

Contrary to the Underwriter Defendants' contention here, nothing in Gustafson changed this rule. As Judge Sweet observed, Gustafson involved neither a Section 11 claim nor a public offering. Adair, 179 F.R.D. at 131. Nor for that matter did Gustafson even address the issue of standing under the securities laws. Rather, the issue in Gustafson was whether a private agreement to sell securities, executed twenty years after the issuance of the stock, constituted a "prospectus" under Section 12. The Supreme Court held that because the purchase agreement was a private secondary transaction rather than a public offering, it was not a "prospectus" for purposes of Section 12. See Gustafson, 513 U.S. at 584.[18]

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[18] Here, as in Adair, the Underwriter Defendants cite to language in the dissenting opinions of Justices Ginsburg and Thomas in Gustafson as support for their argument. However, as explained by Judge Sweet, the statements were relied upon merely for the self-evident and undisputed proposition that Section 11 does not extend to private offerings.

The plain language of Section 11 establishes that standing extends to those whose purchases are traceable to the registration statement. See Landreth Timber Co. v. Landreth, 471 U.S. 681, 685 (1985). As Judge Sweet explained, Section 11(a) applies to "any person acquiring such security" and further provides that if a "person acquired the security after the issuer has made generally available to its security holders an earnings statement covering a period of at least twelve months beginning after the effective date of the registration statement," then the right of recovery is conditioned upon proof that the person actually relied on the false statement in the registration statement. Congress therefore explicitly contemplated that a plaintiff could purchase a registered security well after an offering and still have a remedy under Section 11. See Adair, 179 F.R.D. at 132. To limit standing, as these Defendants urge, would render portions of Section 11 superfluous and meaningless, a result obviously not intended by Congress.[19]

Thus, after-market purchasers have standing to assert Section 11 claims.

3. HGK Has Standing to Assert Federal Securities Claims

The Underwriter Defendants also argue that HGK lacks standing to bring Section 11 and Section 12(a)(2) claims because HGK is a professional investment manager that purchased WorldCom bonds for its clients and not "on its own account." Underwriters Br. at 15. As set forth below, HGK has standing to bring these claims on its clients' behalf.

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[19] Section 11(e)'s damages provision further supports this conclusion. 179 F.R.D. at 133. Under Section 11(e), damages are calculated based on the difference between the amount paid for the security, not exceeding the price at which it was offered to the public, and, inter alia, its value as of the time suit is brought. See 15 U.S.C. § 77k(e). As explained in DeMaria v. Andersen, "If Section 11 applied only to initial purchasers, all sales would be at the offering price and the statutory language capping damages at the price 'the security was offered to the public' would be surplusage. To give meaning to this clause, Section 11 must apply to secondary market transactions." 153 F. Supp. 2d at 310 (citing Milman, 192 F.R.D. at 108, and Adair, 179 F.R.D. at 133).

An overwhelming majority of courts have held that investment managers are not required to purchase securities on their own account to have standing in securities fraud suits because the determinative factor in terms of standing is not the source of funds used for purchase of the security, but "[the] level of [plaintiff's] involvement in the decision to purchase [the] stock." Medline Indus. v. Blunt, Ellis & Loewi, Inc., No. 89 C 4851, 1993 U.S. Dist. LEXIS 581, at * 5-6 (N.D. Ill. Jan. 20, 1993) (rejecting defendants' argument that plaintiff lacked standing to sue for securities fraud violation because stock purchases were paid for by plaintiff's husband); Ezra Charitable Trust v. Rent-Way, Inc., 136 F. Supp. 2d 435, 442 (W.D. Pa. 2001) (rejecting argument that because [investment manager] had not purchased on its own account it does not qualify as a "purchaser" under the federal securities laws, and holding that investment manager's unrestricted decision-making authority was sufficient to find it was a "purchaser" with standing to sue in its own name); Alfaro v. CapRock Communications, No. 1613, 2000 U.S. Dist. LEXIS 21743, at *10 (N.D. Tex. Dec. 8, 2000) (investment manager had standing to sue because it had decision-making authority and made purchase of CapRock stock on behalf of its six clients).

Indeed, most recently, courts have appointed investment advisors as lead plaintiffs, reasoning that this type of investor "fits the profile of the kind of investor Congress had in mind when it enacted the Reform Act." In re Razorfish, Inc. Sec. Litig., 143 F. Supp. 2d 304, 311 (S.D.N.Y. 2001); see also In re Cendant Corp. Litig., 182 F.R.D. 144, 146 (D.N.J. 1998) (appointing investment manager as sole lead plaintiff on behalf of purchasers of Feline Prides securities).

Here, like in Ezra and the other cases cited above, HGK had unrestricted decision-making authority to purchase the WorldCom notes. HGK is a registered "investment advisor" under the Investment Advisors Act of 1940, 15 U.S.C. § 80b, and an "investment manager" under the Employee

Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1002(21). ¶ 21. The ERISA statute defines the term "investment manager" as "any fiduciary . . . who has the power to manage, acquire, or dispose of any asset of a plan. . . ." 29 U.S.C. § 1002(38) (emphasis added). HGK serves as a "fiduciary" under ERISA vis-a-vis its union sponsored pension and benefit fund clients. ¶ 21. Consequently, because HGK was an investment manager and fiduciary under the ERISA statute with exclusive authority to manage, acquire and dispose of its clients' assets -- including the WorldCom bonds -- it has standing to bring securities claims in its own name.

In response to this overwhelming legal authority, the Underwriter Defendants cite cases that are either distinguishable or support HGK's position. The pertinent holdings in Turkcell, 209 F.R.D. 353, and Smith v. Suprema Specialties, 206 F. Supp. 2d 627 (D.N.J. 2002), are easily distinguishable from the case at bar, because the investment managers in those cases did not have full authority to manage their clients' accounts, as HGK did here. Similarly, Hanna Mining Co. v. Minn. Power and Light Co., 573 F. Supp. 2d 1129 (C.D. Cal. 1999), is not relevant because the issue there was whether an agent could assert a principal's breach of contract claim. The holding in Takeda v. Turbodyne Tech., Inc., 67 F. Supp. 2d 1129 (C.D. Cal. 1999), actually supports HGK's position. In Takeda, the court found that an investment manager had standing to prosecute securities fraud claims and indeed appointed it as a lead plaintiff, specifically observing that the manager's inclusion would add sophistication to the [lead plaintiff's] oversight of counsel, and [would] further the goals of the Reform Act." 67 F. Supp. 2d at 1135-36 n.18.

In light of the foregoing, HGK, a fiduciary that exercised its unrestricted decision-making authority to purchase WorldCom bonds in each of the Offerings, has standing to assert the

Securities Act claims alleged in Counts IV and V.[20]

D. The Named Plaintiffs Have Stated a Claim under Section 12(a)(2)

The Underwriter Defendants also argue that the Named Plaintiffs' Section 12(a)(2) claims fail because they do not allege that each Named Plaintiff purchased bonds from, or was actually solicited by, each Underwriter Defendant. Underwriters Br. at 20-24. This argument is similarly without merit because the Complaint adequately pleads that the Underwriter Defendants are "sellers" within the meaning of Section 12(a)(2).

As noted above, Section 12(a)(2) attaches liability to "[a]ny person . . . who offers or sells a security . . . by means of a prospectus or oral communication." While the statute itself does not define the term "seller," the Supreme Court interpreted that term in the context of Section 12(1) in Pinter v. Dahl, 486 U.S. 622, 642-47 (1988), and the Second Circuit adopted that definition as applicable to claims under Section 12(2) (which is now Section 12(a)(2)). See Capri v. Murphy, 856 F.2d 473, 478 (2d Cir. 1988).

As defined in Pinter, a seller is anyone who either (1) "passed title, or other interest in the security to the buyer for value" or (2) "who successfully solicits the purchase [of securities], motivated at least in part by a desire to serve his own financial interests or those of the securities owner." 486 U.S. at 646-47. Contrary to the Underwriter Defendants' contention (Underwriters Br. at 21-22), the Supreme Court specifically rejected the proposition that contractual privity between seller and purchaser is required to establish liability under Section 12, finding that such a requirement would be

[20] Even if this Court were to find that HGK does not have standing here, the effect on Counts IV and V would be a nullity. Between them, the other Named Plaintiffs, FCERA and Fresno, each purchased WorldCom Notes directly in both of the Offerings (¶¶ 19-20) and, as explained above, have standing to bring Section 11 and 12(a)(2) claims on behalf of the Class. There are other institutional investors as well who purchased WorldCom bonds, and are available to serve as named plaintiffs.

inconsistent with the overall purpose behind the securities laws: "to promote full and fair disclosure of information to the public in the sale of securities." Id. As Judge Spatt later observed, "Pinter established that collateral participants to a sale can still be liable under Section 12, even in the absence of privity with the actual seller, if the participant solicited the sales for financial gain." In re Twinlab Corp. Sec. Litig., 103 F. Supp. 2d 193, 204 (E.D.N.Y. 2000).

Following the Supreme Court's guidance in Pinter, courts in this and other districts have held that underwriters in a "firm commitment underwriting," which took place here, are sellers for purposes of Section 12(a)(2), even where, like here, the complaint only alleges "solicitation of unspecified investors." In re Am. Bank Note Holographics, Inc. Sec. Litig., 93 F. Supp. 2d 424, 438-39 (S.D.N.Y. 2000) (emphasis added); see also In re Unicapital Corp. Sec. Litig., 149 F. Supp. 2d 1353, 1366 (S.D. Fla. 2001) ("[u]nderwriters are plainly subject to . . . Section 12(a)(2) liability"); Abell v. Potomac Ins. Co., 858 F.2d 1104, 1114 n.8 (5th Cir. 1988) ("Just as Ford and General Motors never sell directly to consumers, many issuers never sell their securities directly to investors . . . . To the extent that issuers and underwriters use an analogous system to distribute securities, they too may be sellers from whom one buys products.").

Indeed, the decision in American Bank is directly on point. There, as here, the underwriter defendants argued that plaintiffs' failure to allege that they purchased stock directly from the underwriters, or that the underwriters directly solicited plaintiffs' purchases of stock, required dismissal of the Section 12(a)(2) claim. 93 F. Supp. 2d at 437. Judge McMahon expressly rejected this argument and held that, because the offering in question involved a firm commitment underwriting where the underwriters, not the issuers, directly passed title to the securities to public investors, the underwriters were sellers under the first prong of the Pinter test. Id. at 438-39 (citing Jackson Nat'l

Life Ins. Co. v. Merrill Lynch & Co., Inc., 32 F.3d 697, 701 (2d Cir. 1994)). Here, as in American Bank, the Underwriter Defendants entered into firm commitment underwriting arrangements with WorldCom in connection with the 2000 and 2001 Offerings, and therefore were sellers within the meaning of Section 12(a)(2).

Moreover, the Complaint sufficiently alleges that the Underwriter Defendants solicited Class members to purchase WorldCom's bonds, as required by the second prong of the Pinter test. The Complaint alleges that the Underwriter Defendants

> solicited the purchase of the Notes by plaintiffs and other members of the Class, motivated at least in part by the desire to serve the Underwriter Defendants' own financial interest and the interest of WorldCom, including but not limited to commissions on their own sales of the Notes and separate commissions on the sale of the Notes by non-underwriter broker-dealers.

¶ 399. The Complaint also alleges that the Underwriter Defendants "actively solicited the sale of the Notes by participating in 'road show' meetings in furtherance of the Note Offerings." ¶ 400.

These allegations are sufficient for the purposes of pleading Section 12(a)(2) liability against the Underwriter Defendants. See, e.g., In re Opus 360 Corp. Sec. Litig., No. 01 Civ. 2938, 2002 WL 31190157 (S.D.N.Y. Oct. 2, 2002) (allegations that defendants signed registration statement, participated in preparation of registration statement and helped promote the IPO through various "road show" presentations were sufficient for purposes of pleading that defendants were sellers within meaning of Section 12(a)(2)). Contrary to the Underwriter Defendants' contention, Plaintiffs are not required to plead details about each road show. Allegations asserted pursuant to Section 12(a)(2) do not require the same type of specificity as allegations asserting fraud claims. See Billet v. Storage Tech. Corp., 72 F.R.D. 583, 585 (S.D.N.Y. 1976) ("Plaintiffs . . . need not allege fraud in actions brought under Section 11 and 12 of the Securities Act . . . and, to that extent, Rule 9(b) is inapplicable.");

Pollack v. Laidlaw Hold., Inc., No. 90-5788, 1995 WL 261518, at *14 (S.D.N.Y. May 3, 1995) (Cote, J.).

The Underwriter Defendants misleadingly direct this Court to Judge Stein's recent decision in In re Deutsche Telekom AG Sec. Litig., 2002 WL 244597, at *4 (S.D.N.Y. 2002). To support their novel proposition that the Complaint must plead that each Underwriter Defendant solicited each Named Plaintiff, the Underwriter Defendants argue that Judge Stein dismissed a Section 12(a)(2) against the underwriter defendants in Deutsche Telekom because there were "no factual allegations that [any Underwriter Defendant] had direct contact with any [specific Plaintiff], no factual allegation of specific conduct on the part of [any Underwriter Defendant] to solicit purchases of the security other than the fact that [their names] appear on the prospectus, discussing Section 12 claim against Underwriter Defendants." Underwriters Br. at 23 (allegedly quoting Deutsche Telekom 2002 WL 244597, at *5) (brackets and emphasis in brief). Judge Stein held nothing of the sort. To the contrary, in Deutsche Telekom, Judge Stein did not dismiss a Section 12(a)(2) claim against the underwriter, partly because the offering at issue was a firm commitment offering in which the underwriters were statutory sellers within the meaning of Section 12(a)(2). Id. at *4. Thus, Deutsche Telekom actually supports the proposition that the Underwriter Defendants are sellers, and, therefore, appropriate Section 12(a)(2) defendants.[21]

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[21] Other cases cited by the Underwriter Defendants are equally inapposite. In Morin v. Tripin, 747 F. Supp. 1051, 1064 (S.D.N.Y. 1990), the complaint made general solicitation allegations against all of the defendants in the class action. Here, the Complaint makes allegations specifically against the Underwriter Defendants. In Xomo Corp. Secs. Litig., No. C-91-2252, 1990 WL 357807 (N.D. Cal. Dec. 27, 1991), the complaint failed to allege that the underwriter defendants solicited the purchases of the securities, and in any event, the court gave plaintiffs leave to amend the complaint after discovery. Here, the Complaint alleges that the Underwriter Defendants solicited the purchases of the securities. ¶¶ 399-400.

Finally, it is not necessary, as the Underwriter Defendants contend, for plaintiffs to have sold or tendered their bonds prior to the commencement of this action. The language of the statute does not specify a time for tender. See Wigand v. Flo-Tek, Inc., 609 F.2d 1028, 1034 (2d Cir. 1980) (the "language of the section gives no hint as to the time, place or manner of such tender"). Indeed, courts have held that tender can be accomplished at any time prior, to or even during, trial of the action. See Jubran v. Musikahn Corp., 673 F. Supp. 108 (E.D.N.Y. 1987)
("neither the statute nor the cases specify the time for tender" and "the failure to allege a tender of securities in the Second Amended Complaint does not require dismissal of plaintiffs' Section 12(2) claim"); Gridley v. Cunningham, 550 F.2d 551, 554 (8th Cir. 1977) ("as no time for tender is prescribed by Section 12 . . . a tender prior to or during trial satisfies the purpose for the tender"). In sum, the Complaint adequately alleges claims under Sections 11 and 12(a)(2) of the Securities Act.[22]

For all these foregoing reasons, the Securities Act claims in Counts I, III, IV, and V should not be dismissed.

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[22] In what can only be considered a throwaway argument, the Underwriter Defendants contend that certain Underwriter Defendants should be dismissed from claims asserted by FCERA and other Underwriter Defendants should be dismissed from claims asserted by Fresno. Underwriters Br. at 14-15. This argument, which would result in an order of no practical effect, misunderstands both the Complaint and the nature of notice pleading under the Federal Rules of Civil Procedure. The Complaint clearly identifies those Defendants who acted as underwriters for the 2000 Offering and separately identifies the Defendants who acted as underwriters for the 2001 Offering. ¶¶ 45, 48-65, 196-211. Nowhere does the Complaint allege that the underwriters of the 2000 Offering are liable to FCERA or any other purchaser of securities pursuant to the 2001 Offering, nor does the Complaint allege that the underwriters of the 2001 Offering are liable to Fresno or any other purchaser of the 2000 Offering. Rather, Counts IV and V are logically organized not by the year the securities were offered but by the section of the Securities Act under which they are brought (i.e., Section 11 and Section 12(a)(2)). Each count states claims against all the Underwriter Defendants and, when read in light of the earlier description of each Underwriter Defendant's participation, adequately gives notice of the claims asserted against each underwriter. Thus, the "claims" that Defendants seek to dismiss are non-existent and their motion should be denied on this ground as well.

POINT II

THE COMPLAINT STATES CLAIMS UNDER
SECTION 10(b) OF THE EXCHANGE ACT

This case involves an admitted fraud perpetrated for over three years which resulted, among other things, in massive overstatements of earnings -- over $9 billion -- in WorldCom's financial statements for the years 1999, 2000, 2001 and the first quarter of 2002, and, eventually, the largest bankruptcy filing in United States history. That the fraud occurred is not in dispute. Nor can it be disputed that the fraudulent financial statements were integral to WorldCom raising nearly $17 billion through the sale of publicly-traded debt securities in May 2000 and May 2001
-- pursuant to registration statements that were signed by each of the Director Defendants, underwritten by Salomon and the other Underwriter Defendants, and that included certifications by Andersen that the financial statements in the registration statements had been audited in compliance with generally accepted auditing standards ("GAAS"), and fairly presented in all material respects the financial condition of WorldCom. That the fraud caused billions of dollars of losses to public investors of WorldCom is likewise uncontrovertible. In such a situation, involving a massive securities fraud, "there are likely to be multiple violators." Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994); see also SEC v. U.S. Environmental, Inc., 155 F.3d 107, 112 (2d Cir. 1998); Cromer Fin. Ltd. v. Berger, 137 F. Supp. 2d 452, 481-82 (S.D.N.Y. 2001) (Cote, J.). Notwithstanding that WorldCom represents the largest securities fraud in the history of the United States, each of the movants against whom Section 10(b) fraud claims are asserted seeks to have the claims dismissed. They all say: "not me!" But, as more fully described below, the claims asserted in the Complaint against each of the fraud claim Defendants should be upheld.

To establish liability under Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, a plaintiff must allege that in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information and that plaintiff's reliance on defendant's action caused the plaintiff injury. See, e.g., Rothman v. Gregor, 220 F. 3d 81, 89 (2d Cir. 2000); Cromer Finance, 137 F. Supp. 2d at 468. A plaintiff alleging securities fraud must also comply with the requirements of Fed. R. Civ. P. 9(b) and the relevant provisions of the PSLRA. See, e.g., Cromer Finance, 137 F. Supp. 2d at 468. In order to comply with those requirements, a plaintiff must specify: (1) the statements the plaintiff believes are fraudulent; (2) the speaker; (3) where and when the statements were made; and (4) why the plaintiff believes the statements are fraudulent. See id. Further, when pleading scienter pursuant to the PSLRA, with respect to each act or omission alleged to have violated the securities laws, the complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2).

In this Circuit, plaintiffs may establish a "strong inference" of scienter in one of two ways "(a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." Ganino v. Citizens Utils. Co., 228 F.3d 154, 168-69 (2d Cir. 2000). Either method is sufficient for pleading the requisite intent under Fed. R. Civ. P. 9(b). Id. at 170. Conscious misbehavior or recklessness is adequately pled by alleging that the defendants (1) deliberately engaged in illegal behavior; (2) knew facts or had access to information suggesting that their public statements were not accurate; or (3) failed to check information they had a duty to monitor. Elliott Assocs., L.P. v. Hayes, No. 00 Civ. 4483 (SAS), 2000 WL 1886585, at *5 (S.D.N.Y. Dec. 29, 2000) (citation

omitted); see also Cromer Finance, 137 F. Supp at 468-69 ("Recklessness has been sufficiently pled where there are specific allegations that a defendant knew of facts or had access to information contradicting his public statements, or where he failed to review information that he had a duty to monitor, or where he ignored obvious signs of fraud"); Novak v. Kasaks, 216 F.3d 300, 308 (2d Cir. 2000) (securities fraud claims typically upheld where there are allegations that the "defendants' knowledge of facts or access to information contradict[ed] their public statements. Under such circumstances, defendants knew or, more importantly, should have known, that they were misrepresenting material facts related to the corporation."). Where a complaint alleges that defendants "knew or had access to non-public information contradicting their public statements, recklessness is adequately pled for defendants who knew or should have known they were misrepresenting material facts with respect to the corporate business." In re Scholastic Corp. Securities Litigation, 252 F.3d 63, 76 (2d Cir. 2001).

To plead facts supporting a strong inference of the requisite scienter by showing motive and opportunity, a plaintiff must allege facts "showing concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged, and the means and likely prospect of achieving the concrete benefits by the means alleged." Cromer Finance, 137 F. Supp. at 469 (quotations and citations omitted); accord Scholastic, 252 F.3d at 74 (motive focus is on "a concrete benefit defendant would realize by his conduct").

The Complaint asserts three sets of Section 10(b) claims: Count VI is against Ebbers, certain other WorldCom executives and five WorldCom Directors, including Kellett, Bobbitt, Allen, Areen, and Galesi (collectively, the "Section 10(b) Director Defendants"); Count VIII is against the Andersen Defendants; and Counts IX and X are against Salomon and Grubman.

A. The Section 10(b) Claim Against Ebbers Must Be Sustained

Ebbers' fingerprints are all over the fraud at WorldCom. As reported in Business Week on September 23, 2002, a spokesman for the House Committee on Energy and Commerce investigating WorldCom noted that a review of the evidence "led the Committee to think Bernie Ebbers is up to his eyeballs in . . . [WorldCom's accounting fraud]." ¶ 295 (emphasis added). Moreover, spokespersons for the House Committee on Financial Services, which had also been investigating the fraud, stated that Sullivan, who had direct personal knowledge of the accounting improprieties, told WorldCom's internal investigators that "Ebbers was aware that hundreds of millions of dollars had been moved" into capital expenditures to avoid having an impact on the Company's earnings. Id.

Ebbers' own statements revealed that he knew precisely how WorldCom's financial results were being manipulated. By no later than early 2000, WorldCom's senior officers were well aware that WorldCom's revenues were falling precipitously and that this decline "created a substantial risk that WorldCom's publicly reported income would fail to meet the expectations of Wall Street analysts." ¶ 89. WorldCom's management also knew that, if the Company failed to meet expectations, it would have a disastrous impact on the price of WorldCom's stock and publicly traded debt. Id. To avoid this outcome, WorldCom began to manipulate its earnings by tapping into its reserves. ¶¶ 89-91. Ebbers had direct knowledge of these accounting manipulations; at a senior staff meeting in 2000, Ebbers assured his senior executives that WorldCom "won't have to worry about earnings for years" because, if necessary, the Company would tap into reserves to boost its results. ¶ 296(b).

Similarly, before the Company announced its results for the fourth quarter of 2000, Ebbers attended a meeting with Sullivan and other senior WorldCom executives, where they decided to "do whatever [was] necessary" to report margins in line with analysts' expectations. Ebbers and Sullivan,

his hand-picked CFO, then ordered that WorldCom's internal auditors be prohibited from reviewing the Company's financial reporting and internal controls (see ¶ 433(a)). In March 2002, when the SEC investigation was announced and the noose began to tighten, Ebbers sought to slash the budget for the internal audit function in half. ¶ 296(b).

Ebbers had an opportunity to respond to questions about what he did or did not know about the fraud when he testified before Congress on July 8, 2002. Rather than explain to the nation how a fraud of such staggering proportions could occur on his watch, he invoked the Fifth Amendment, refusing to testify because he did not wish to incriminate himself. ¶ 106.

Ebbers -- the "visionary" who transformed WorldCom into the world's second largest telecommunications company, who consistently made bullish statements in press releases and analyst conference calls extolling WorldCom's "record" financial results and defending its accounting practices (¶¶ 112-91), and who was known to be a "hands-on manager" who kept a close eye on expenses (¶ 296 (a)) -- now asks this Court to dismiss the claims against him, arguing that the Complaint fails to plead scienter. His arguments have a hollow ring.

Ebbers does not dispute that the Complaint's allegations, if taken as true, are sufficient to establish a strong inference of scienter. Rather, he makes a series of arguments that the Court may not consider when deciding this motion to dismiss. For example, Ebbers argues that the statements attributed to Sullivan and Congressional investigators which directly link him to the fraud are based on "wholly unreliable" sources who have "their own agendas." Ebbers Br. at 19. However, it is not the province of a court on a motion to dismiss to weigh the credibility of witnesses or facts presented in the Complaint. See, e.g., Jackson Nat'l Life Ins. v. Merrill Lynch & Co., 32 F.3d 697, 699-700 (2d Cir. 1994) (in considering motion to dismiss, court must take "as true the facts alleged in the complaint and

draw . . . all reasonable inferences in the plaintiff's favor"). Moreover, Lead Plaintiff submits that these sources can hardly be deemed unreliable. Sullivan was a principal architect of the fraud, and had direct personal knowledge of the fraudulent reductions of merger reserves and line cost transfers. Similarly, the statements made by Congressional investigators were made after they had conducted an extensive investigation into the alleged misconduct.

Ebbers also takes issue with the source of these allegations, complaining that they are taken from newspaper articles and other periodicals. However, it is well-established that plaintiffs may rely on facts derived from articles in reputable newspapers and business periodicals when pleading a complaint -- especially where, as here, the fraud has been subject to so much scrutiny. See, e.g., Lewis v. Curtis, 671 F.2d 779, 788 (3d Cir. 1982) ("Reliance on an article in The Wall Street Journal is not reliance on an insubstantial or meaningless investigation. Plaintiffs and their attorneys need not make further expenditures to prove independently that which may be read with some confidence of truthfulness and accuracy in a respected financial journal."); Cerasani v. Sony Corp., 991 F. Supp. 343, 354 n.3 (S.D.N.Y. 1998) (taking judicial notice of widespread newspaper coverage and collecting cases on the propriety of taking such notice in cases involving "substantial media coverage" and "widespread publicity via newspaper and television news").[22]

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[22] Ebbers also argues that the allegation that he sought to slash the budget for internal auditors in half is immaterial because it shows only that Ebbers was "concerned" about the Company's overall expenses and that, in any event, the Board thereafter decided to cut the internal auditors' budget by only 10 percent. See Ebbers Br. at 24. Even if the Court were to accept Ebbers' invitation to grant him the least damning inference (which it should not do), in view of the enormity of the fraud, and the fact that it was ultimately the internal audit department that revealed the fraud, the more plausible inference is that what he was actually "concerned" about was this department's ability to discover the multi-billion dollar fraud.

In addition, Ebbers contends that this Court may not consider the fact that he invoked the Fifth Amendment as probative of scienter, because in a civil proceeding, a party's assertion of the Fifth Amendment cannot, standing alone, support a finding of liability, and because plaintiffs have supposedly not been prejudiced by his refusal to testify. Ebbers Br. at 12. First, Lead Plaintiff does not claim that the invocation of the Fifth Amendment alone establishes Ebbers' liability for securities fraud in this case; rather, this is but another fact that the Court can consider when assessing the sufficiency of the pleadings. At this stage of the litigation, Lead Plaintiff is entitled to have its inference credited, that is, that Ebbers refused to testify because his answers would have confirmed he had culpable knowledge of the fraud. See Baxter v. Palmigiano, 425 U.S. 308, 318 (1976) ("[T]he Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify.").[23] Ebbers cannot use his silence as a sword and a shield in this civil action, by invoking the Fifth Amendment and then claiming that the Court may not consider that fact when assessing the sufficiency of the pleadings.[24]

Ebbers also argues that the size of the fraud at his company -- no matter how large -- provides no support for the claims of fraud against him. Ebbers Br. at 11-12. While Lead Plaintiff deals with

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[23] Moreover, contrary to what Ebbers contends, the Class has been prejudiced by his refusal to testify before Congress. In the context of federal securities litigation, where plaintiffs must plead facts warranting a strong inference of scienter without the benefit of any discovery, Ebbers' testimony to Congress would have clearly advanced plaintiffs' investigation and shed light on his involvement in the fraud. As the Third Circuit explained, "invocation of the Fifth Amendment poses substantial problems for an adverse party who is deprived of a source of information that might conceivably be determinative in a search for the truth." SEC v. Graystone Nash, Inc., 25 F.3d 187, 190 (3d Cir. 1994).

[24] Ebbers' reliance on Fujisawa Parmaceutical v. Kapoor, No. 92 C 5508, 1999 WL 543166, at *9 (N.D. Ill. July 21, 1999) is misplaced. In Fujisawa, the Court held that it would be improper at a trial to draw an adverse inference from the defendant's assertion of his Fifth Amendment privilege in a Congressional hearing when he had subsequently withdrawn that assertion and testified at a deposition. 1999 WL 543166, at *9. In contrast, here, the Court is asked merely to draw an adverse inference in the context of assessing the sufficiency of Lead Plaintiff's pleading, when Ebbers' refusal to testify has not been superceded by any other testimony.

this argument in greater detail below, we note here that Ebbers' argument is directly contrary to the law in this Circuit. See, e.g., Scholastic, 252 F.3d at 73 ("The $13 million pre-tax special charge taken by Scholastic in February 1997 lends yet more support to the notion that defendants had knowledge of increasing returns."); Rothman, 220 F.3d at 92 ("we deem significant the amount of the write-off GT eventually did take for the final quarter of 1997"). Significantly, in these cases, the accounting improprieties paled in comparison to the $9 billion of phony earnings WorldCom reported. Indeed, if there was ever a case where the magnitude and egregiousness of the fraud alone should create a strong influence of scienter, this is undoubtedly that case. The size of the fraud is especially telling with respect to Ebbers, whom news reports have stated kept a very close eye on expenses, and whose office adjoined Sullivan's. ¶ 296(d). As observed by The Wall Street Journal on July 1, 2002, it is inconceivable that a CEO with the eye for numbers and expenses that Ebbers had could have missed the improper transfers of billions of dollars on WorldCom's books. Id.

Finally, Ebbers argues that scienter may not be inferred because he is not familiar with the supposed intricacies of GAAP. Ebbers Br. at 20-21. The facts belie this argument. When WorldCom's accounting practices came under scrutiny in early 2002, Ebbers vehemently defended the Company's accounting practices in public. For example, when questions were raised about WorldCom's accounting during a February 7, 2002 analyst conference call -- based on the announcement that WorldCom would likely write-down good will by between $15 and $20 billion -- Ebbers stated without equivocation: "we stand by our accounting." ¶ 180. Similarly, when WorldCom became the subject of an SEC inquiry in March 2002, Ebbers assured investors that WorldCom's accounting policies and practices were fully compliant with SEC rules. ¶ 184. These are not the statements of a person unfamiliar with WorldCom's accounting, but a CEO who professed to be very

much in charge and knowledgeable about every aspect of his company. Moreover, as set forth above, the accounting improprieties that occurred were not complicated and did not involve difficult interpretations of GAAP. Rather, in the words of one accounting expert, this was "basic stuff." ¶ 318.[25]

The Complaint also sufficiently pleads that Ebbers had ample motive and opportunity to commit the fraud. By the end of the Class Period, Ebbers had borrowed approximately $900 million from various lenders -- including WorldCom and Travelers -- much of which was secured by his holdings of WorldCom stock. ¶¶ 129, 297. Ebbers' loans from WorldCom, which were all secured by his WorldCom stock, amounted to approximately $400 million, by far the largest corporate loans to an executive in history. Id. Thus, as WorldCom's stock price was falling, Ebbers was under tremendous pressure to satisfy the margin calls from his lenders and avoid personal bankruptcy. In 2000 and 2001, Ebbers was under such pressure from his lenders that one of Sullivan's close confidants observed that "[Ebbers] was margined out of his mind." Id.

During the Class Period, Ebbers also sold millions of shares of WorldCom's stock through a hedging transaction. In early fall of 2000, after government officials blocked WorldCom's merger with Sprint, Ebbers effectively sold approximately $70 million of stock. ¶ 298. Ebbers structured the transaction as a forward contract to disguise the obvious effects on WorldCom's share price if he, the visionary CEO, dumped several million shares on the market immediately following the collapse of this deal. Id. As a result, Ebbers locked in a sure $70 million to protect himself once the stock price

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[25] Ebbers also suggests that he is not liable in this civil suit because he has not yet been indicted. Ebbers Br. at 20-21. Lead Plaintiff is not aware of any case that holds that a defendant must be indicted for a Section 10(b) claim to be sustained.

dropped while, at the same time, he sought to protect the inflated value of WorldCom's stock.

Ebbers' argument that his loans and hedging transactions are not sufficient to plead motive because they do not make economic sense is without merit. Ebbers Br. at 14-18. The scheme made perfect economic sense. So long as WorldCom's stock remained inflated, Ebbers' lenders would be kept at bay, WorldCom could continue its acquisition binge and hide its earnings deficiencies, and Ebbers could continue to reap millions of dollars in profits from being one of the most powerful CEOs in corporate America.

Ebbers also argues that the fact he continued to hold substantial portions of his WorldCom stock negates his scienter. Ebbers Br. at 15. This argument is disingenuous because Ebbers could not sell his stock, and did not need to in order to line his pockets with cash. As described in detail in the Complaint, when in the fall of 2000 Ebbers tried to sell tens of millions of dollars worth of his stock to satisfy margin calls, the Board, fearing the impact this would have on the stock price, told him not to sell the stock and instead provided him with loans of $400 million to cover his debt. ¶ 297(a)-(e). Those loans were at a much lower interest rate than the market rate, and both Ebbers and the Board knew that the Board would never ask Ebbers to repay them as long as Ebbers remained CEO. Thus Ebbers had the best of both worlds -- he could keep his stock and still obtain hundreds of millions of dollars in cash from a Board that was utterly derelict in fulfilling its responsibilities to WorldCom's shareholders.[26]

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[26] For the same reason, Ebbers' reliance on Coates v. Heartland Wireless Communication, Inc., 26 F. Supp. 2d 910 (N.D. Tex. 1998) is misplaced. Contrary to Ebbers' contention, the court in Coates did not hold that avoidance of margin calls may never constitute motive within the meaning of Section 10(b). Rather, the court held that where defendants could have easily sold stock to satisfy their lenders and did not do so, scienter was not sufficiently alleged. As noted above, unlike the defendants in Coates, Ebbers had close to $900 million in loans, and as WorldCom's CEO, he could not simply dump hundreds of millions of dollars of stock on the market to satisfy his lenders. As Ebbers himself

Ebbers' motive to artificially inflate the price of WorldCom's stock may be further derived from the fact that Ebbers' vision for WorldCom's growth strategy was fueled by the Company's stock-for-stock acquisition binge. During the Class Period, Ebbers sought unsuccessfully to consummate his largest acquisition ever -- the $129 billion Sprint transaction announced in October 1999 which was valued at $129 billion -- and acquired Sky-Tel and Intermedia using WorldCom stock as the purchasing currency. ¶¶ 87, 212, 216. Indeed, this acquisition strategy was crucial to WorldCom's survival, because with each acquisition WorldCom established huge reserves which Ebbers knew could be drawn down when needed to cushion WorldCom's reported earnings. ¶¶ 80-84. Numerous courts in this and other districts have held that specific allegations that a Company inflated its stock price to pursue acquisitions that were critical to its business prospects are sufficient to plead scienter. See, e.g., Burstyn v. Worldwide Xceed Group, No. 01 Civ. 1125, 2002 WL 31191741, at *5 (S.D.N.Y. Sept. 30, 2002) (acquisition program provided "specific goal" that could satisfy motive and opportunity pleading requirement); In re Complete Mgmt. Sec. Litig, 153 F. Supp. 2d. at 328 (plaintiffs' allegation that defendants sought to maintain artificially high stock price so that defendant company could use stock as currency for acquisitions sufficiently alleged concrete motive to support strong inference of scienter); RMED Int'l, Inc. v. Sloan's Supermarkets, Inc., 207 F. Supp. 2d 292 (S.D.N.Y. 2002) (defendants had motive to artificially inflate value of stock in order to use it to acquire other companies).

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has admitted (¶ 297(a)), such a move would have caused WorldCom's share price to take a huge dive, to Ebbers' detriment as a shareholder and as the architect of WorldCom's growth by acquisition strategy.

In sum, the NYSCRF has clearly pled sufficient facts -- by showing Ebbers' knowledge, recklessness, and motive and opportunity -- to support a strong inference that Ebbers acted with scienter.[27]

B. The Section 10(b) Claims Against the Section 10(b) Director Defendants Must Be Sustained

The Complaint similarly asserts viable fraud claims against Defendants Allen, Areen, Bobbitt, Galesi (the "Audit Committee Defendants") and Kellett (together with the Audit Committee Defendants, the "Section 10(b) Director Defendants"). In their motion, these Defendants make two basic arguments: (1) they cannot be held liable because they did not make any false and misleading statements; and (2) the Complaint fails to plead that they acted with scienter. Neither of these arguments withstands scrutiny.[28]

First, the Complaint sets forth numerous materially false and misleading statements that each Section 10(b) Director Defendant made. While these Defendants go on at great length about how they cannot be held liable under the "group pleading" doctrine (Directors Br. at 8-11), this argument is a sideshow; the Complaint does not allege that these Defendants are liable under the group pleading doctrine.[29] Rather, the Complaint alleges that these Defendants are liable only for those statements that

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[27] Ebbers' other argument -- that neither he nor the Company had a duty to disclose the materially conflicted relationship between WorldCom, Ebbers and Salomon in the registration statements issued in connection with the Offerings -- is discussed in Point II.D. As discussed there, this argument is also without merit.

[28] The Section 10(b) Director Defendants also contend that the Complaint fails to plead control person liability pursuant to Section 15 of the Securities Act and Section 20(a) of the Exchange Act. For the reasons stated in Point III. below, these arguments should likewise be rejected.

[29] The Complaint does allege that it is appropriate to apply the group pleading doctrine to one "narrowly defined group of defendants" consisting solely of Ebbers, Sullivan, Myers, Yates, the four senior WorldCom officers named as Defendants. ¶ 66.

they specifically made. For example, each of the Section 10(b) Director Defendants signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2001; and the registration statements related to each of the Offerings. ¶¶ 26, 27, 29, 30, 33, 132, 154, 185, 197, 204, 215, 220.

It is axiomatic that, for purposes of imposing Section 10(b) liability, the signing of an issuer's SEC filings constitutes the making of a statement.[30] This well-settled principle holds true not just for corporate officers, but for all directors. See, e.g., In re Lernout & Hauspie Sec. Litig., 286 B.R. 33, 37 (D. Mass. 2002) (signatures by members of audit committee on various SEC filings which included fraudulent financial statements "satisfy the requirement that defendants make a fraudulent statement"); Thomas Kernaghan & Co. v. Global Intellicom, Inc., 2000 WL 640653, at *5 (S.D.N.Y. May 17, 2000) (Cote, J.) ("filing of allegedly false and misleading documents with the SEC which misrepresented [the company's] financial condition cannot be dismissed as 'merely preparatory to the fraud,' . . . but rather represent misrepresentations upon which plaintiffs' securities fraud claim may be premised"); In re JWP Inc. Sec. Litig., 928 F. Supp. 1239, 1255 (S.D.N.Y. 1996) (denying summary judgment for audit committee members with respect to statements made in Form 10-Ks that audit committee members signed); see also Howard v. Everex Sys., 228 F.3d 1057, 1061 (9th Cir. 2000) ("a director who has the requisite level of scienter and signs a fraudulent Form 10-K can be liable as a primary violator of §10(b) for making a false statement"). Thus, the Complaint does not rely upon the group pleading doctrine with respect to the Section 10(b) Director Defendants, and all of the cases that

[30] This is true because "SEC filings generally are the type of 'devices' that a reasonable investor would rely on in purchasing securities of the filing corporation." Itoba Ltd. Lep Group PLC, 54 F.3d 118, 123 (2d Cir. 1995).

they cite on this issue -- which concern cases where plaintiffs were seeking to hold outside directors liable for publicly-filed documents which they did not sign -- are inapposite.[31]

Second, the allegations of the Complaint establish a strong inference of scienter with respect to these Defendants. The Audit Committee Defendants were specifically charged with responsibility for ensuring the accuracy and integrity of WorldCom's publicly-filed financial statements. Indeed, the SEC has stated that "[a]udit committees play a critical role in the financial reporting system by overseeing and monitoring management's and the independent auditor's participation in the financial reporting process. Audit committees may, and should, be the corporate participant best able to perform that oversight function." ¶ 311 (quoting Audit Committee Disclosure, Exchange Act Release No. 34-42266, 71 SEC Docket 787, 1999 WL 1244029, at *3 (Dec. 22, 1999)) (emphasis added). WorldCom's own SEC filings represented to investors that the members of the Audit Committee exercised strict oversight over the Company's financial reporting process, including reviewing WorldCom's financial statements, communicating with Andersen, reviewing the Company's internal accounting controls, and making recommendations to the Board as to the selection of the accountants. ¶ 313.

As the Complaint alleges, the Audit Committee utterly failed to discharge its responsibilities. The Complaint is replete with specific allegations sufficient to establish a strong inference that the Audit Committee Defendants were at least reckless. As this Court held in Cromer Finance, recklessness is adequately alleged when a defendant (a) knew of facts or had access to information contradicting his

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[31] See In re Aetna, Inc. Sec. Litig., 34 F. Supp. 2d 935, 939 (E.D. Pa. 1999) (dismissing 10(b) claim where outside director had not signed any allegedly false and misleading document); In re Sensormatic Elec. Corp. Sec. Litig., No. 018346 Civ., 2002 WL 1352427, at *5 (S.D. Fla. June 10, 2002) (same); Powers v. Eichen, 977 F. Supp. 1031, 1041 (S.D. Cal. 1997) (same); Klein v. Goetzmann, 770 F. Supp. 78, 81-82 (N.D.N.Y. 1991) (same).

public statements, (b) failed to review information he had a duty to monitor, or (c) ignored obvious signs of fraud. 137 F. Supp. 2d at 468-69. Here, each of these elements are alleged, as follows:

Facts Concerning Capital Expenditures: In the normal course of events, a board of directors of a public company approves large capital expenditures in advance. ¶ 385. Typically, there is no consistent pattern as to when large capital expenditures occur. ¶ 383. To the contrary, capital expenditures are made as needed, such as when a company needs to make improvements to its physical plant or to install new technology. Id. At WorldCom, however, capital expenditures that were not approved by the Board of Directors were booked in huge amounts on a consistent basis to artificially inflate the Company's financial results. During each quarter of 2001 and through the first quarter of 2002, the Company improperly recorded hundreds of millions of dollars of line cost expenses as capital expenditures after the end of each quarter, in order to meet Wall Street analyst expectations. Id. These fraudulent adjustments were made without any legitimate business reason for doing so and without any supporting documentation. Id.

The amount of line costs that were improperly capitalized is staggering: $771 million for the first quarter of 2001; $610 million for the second quarter of 2001; $743 million for the third quarter of 2001; $931 million for the fourth quarter of 2001; and $797 million for the first quarter of 2002. ¶ 107. The line cost expenses classified as capital expenditures were not within the budgets approved by the Board in advance, nor supported by documentation presented to the Board. ¶ 384. These facts, as well as the manner in which these line cost were improperly capitalized -- after the close of each quarter, and without any supporting documentation or legitimate business rationale -- were all either known to, or at least accessible to the Audit Committee Defendants, who had a duty to monitor such items to fulfill their fiduciary duties to WorldCom and its investors. ¶ 94.

Had the Audit Committee Defendants even come close to exercising the care required of a director -- especially an audit committee member of the board of a public company -- they could have quickly uncovered the fraud with respect to WorldCom's capital expenditures. Had these Defendants performed the fundamental step of comparing WorldCom's actual capital expenditures to its budgeted capital expenditures, they would have discovered that the Company's reported capital expenditures vastly exceeded budgeted numbers -- by numbers approaching a billion dollars each quarter. ¶ 384. This fact alone would have required the Audit Committee Defendants to ask about the nature and necessity of the expenditures -- knowing that they had not pre-approved such massive capital expenditures. Had these Defendants merely asked the question, they could have uncovered the truth -- that there were no such expenditures and that WorldCom was improperly capitalizing its ordinary expenses to make its quarterly earning numbers.

Facts Concerning Reduction of Merger Reserves: One of the key elements of the fraud was WorldCom's reduction of line cost expenses during the third and fourth quarters of 2000 in the amounts of $828 million and $407 million, respectively -- a total of $1.235 billion -- with corresponding claimed reductions in the Company's merger reserves. ¶¶ 91-93, 325, 382. There was no documentation supporting the reduction of merger reserves. ¶ 325. As a result, it is clear that the Audit Committee Defendants, who had a duty to monitor WorldCom's recording of expenses in its financial statements, and who represented in SEC filings that they satisfied that duty by exercising oversight over WorldCom's financial reporting process and reviewing its financial statements, failed to monitor information they had a duty to monitor and further ignored obvious signs of fraud.

Facts Concerning Internal Controls: The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, which was sponsored by the New York Stock

Exchange and the National Association of Securities Dealers ("NASD"), issued a report stating that an audit committee's oversight function includes the responsibility for ensuring that the corporation has internal controls in place specifically to deter management fraud. That report provides:

> [S]uch oversight includes ensuring that quality accounting policies, internal controls, and independent and objective auditors are in place to deter fraud, anticipate financial risks and promote accurate, high quality and timely disclosure of financial and other material information to the board, to the public markets, and to shareholders.

¶ 312 (emphasis added). Yet, as the Complaint alleges, the Audit Committee abrogated its responsibility by failing to take any steps to address what these Defendants knew were material weaknesses in WorldCom's internal controls, and by allowing Ebbers and Sullivan to restrict the Company's internal auditors from investigating or reviewing the Company's financial reports. ¶ 433(a). In fact, as was ultimately revealed, WorldCom had absolutely no internal fraud controls at all. Minutes of a meeting of the Audit Committee on June 6, 2001 reveal that the Audit Committee knew that controls were so deficient that WorldCom employees were able to generate phony sales by simply moving customer accounts from one billing system to another. ¶ 340.

There is thus no question that the Audit Committee Defendants, contrary to their public statements, did not exercise strict oversight over WorldCom's financial reporting process, financial reports, and internal controls. To the contrary, the allegations in the Complaint demonstrate their patent recklessness in these matters.[32]

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[32] These conclusions are shared by former U.S. Attorney General Dick Thornburgh, the Examiner appointed by the Bankruptcy Court to probe the WorldCom debacle on the court's behalf. Examiner Thornburgh was highly critical of WorldCom's internal audit function and the Board as a whole in his First Interim Report ("Report"), filed with the Bankruptcy Court on November 4, 2002. He stated that "the internal audit function at WorldCom failed to satisfy reasonably its important responsibilities," and that this was a direct effect of a "lack of adequate support from WorldCom's senior management, its Board of Directors and the Audit Committee." Report at 52. The Examiner concluded that the Audit Committee failed to perform such basic and fundamental tasks as establishing

Numerous courts have held audit committee defendants liable under Section 10(b) in cases where the fraud was much less significant and much more difficult to discover. For instance, in Lernout & Hauspie, 286 B.R. 33 (D. Mass. 2002) which also involved a massive accounting fraud, the court denied the audit committee members' motion to dismiss, holding that the plaintiffs had sufficiently demonstrated a strong inference of recklessness by alleging that the audit committee members knew that the company's internal controls were insufficient and that the company lacked an internal audit function. 286 B.R. at 38. Rejecting the defendants' argument that they were entitled to rely upon the company's outside auditors, the court specifically held that "the Audit Committee had a duty to oversee the auditors, that is, to guard the guardians." Id. (emphasis added); see also Greenfield v. Prof'l. Care, Inc., 677 F. Supp. 110, 114 (E.D.N.Y. 1987); In re JWP Inc. Sec. Litig., 928 F. Supp. 1239, 1255 (S.D.N.Y. 1996).[33]

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an adequate internal audit plan at the beginning of each fiscal year; paid only "perfunctory attention to the audits performed by the Internal Audit Department"; and failed to address "significant and unresolved internal control weaknesses cited in prior [internal] audits." Report at 56. In fact, the Examiner determined that the Audit Committee had known of "material weaknesses" in internal controls since 1997, and that not only had the Audit Committee failed to take any steps to correct these deficiencies, but there was no "evidence that the senior management of the Company or the Audit Committee expressed any concern regarding this situation." Report at 56-57.

[33] Defendant Galesi's scienter is further demonstrated by the fact that on January 30, 2002, only two weeks before WorldCom announced a $20 billion write-off of goodwill, he sold 2.9 million of WorldCom's shares, which constituted approximately 63% of his total holdings, realizing proceeds of approximately $27 million. ¶ 316. While Galesi claims to have suffered a paper loss on his sales, that is besides the point. Had he continued to hold -- as did thousands and thousands of WorldCom's public shareholders -- his stock would have been worthless. Thus, the sale of nearly two-thirds of his stock, just before the first of the partial disclosures of the fraud at WorldCom, satisfies the motive standard in this Circuit. See Scholastic Corp. Sec. Litig., 252 F.3d at 63, 74-75 (sale of 80 percent of individual defendant's stock within two months of curative disclosure sufficient to allege motive and opportunity on defendant's part for concealing facts that ultimately caused the price of company's stock to drop precipitously).

Similarly, the Complaint alleges scienter with respect to Defendant Kellett. Kellett was the Chairman of the Compensation Committee, and the board member who urged the entire Board to extend to Ebbers hundreds of millions of dollars in loans during the Class Period -- loans secured by Ebbers' holdings of WorldCom stock. This fact alone should have put Kellett, as well as the other Director Defendants, on notice that Ebbers had a powerful incentive to commit fraud, because if WorldCom's earnings fell short of expectations, Ebbers faced personal financial ruin. Indeed, it was well-known by WorldCom's Board and other employees within the Company that Ebbers' loans imposed tremendous pressure on senior management to report strong earnings and keep the stock price inflated. ¶ 297. Kellett, however, had his own powerful incentive -- to look the other way. In return for his "assistance" in having the Board approve Ebbers' loan package, Ebbers had WorldCom provide Kellett with the use of WorldCom's corporate jet for a lease payment of $1 per month. ¶ 306. In addition, Kellett was the only WorldCom director other than Ebbers to receive tens of thousands of shares of hot IPOs from Salomon (¶ 228) -- something which could only have occurred at Ebbers' insistence.[34]

Kellett is also being investigated for several forward sales of WorldCom's stock in November 2000. ¶ 307. At that time, apparently realizing that WorldCom's financial prospects were dim after the collapse of the proposed merger with Sprint, Kellett, under disguise of a forward contract, sold four million shares, representing approximately 67% of his and his affiliated entities' total holdings of

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[34] This conclusion is shared by former SEC Chairman Richard Breeden, who was appointed as the Monitor by the Bankruptcy Court to among other things, review trade expenses at WorldCom or the court's behalf. Monitor Breeden investigated this quid pro quo arrangement and determined that the cost of the jet should have been roughly $1 million a year and that the use of the jet may have influenced Kellett's consideration of Ebbers' compensation; the Monitor called for Kellett's resignation, claiming that he had abused his position as a director. See Joann S. Lublin and Jared Sandberg, WorldCom Director Kellett Quits Under Pressure From the Board, Wall St. J., Oct. 29, 2002.

WorldCom stock, which guaranteed that he would receive $53,566,847 in November 2003. Id. In addition, on December 4, 2001, Kellett sold 50% of his holdings in WorldCom for $11.9 million. ¶ 309. Each of these allegations further supports a strong inference that Kellett acted with scienter.

The size of the restatement also supports the inference that each of the Section 10(b) Director Defendants acted with scienter. As the Second Circuit stated in Rothman v. Gregor:

> The Appellants argue that GT's $73.8 million write-off supports its claim of fraudulent intent. They argue that the magnitude of this write-off renders less credible the proposition that during the GT Class Period, GT believed it likely that it could recover those royalty advances through future sales. We agree.

220 F.3d at 92 (emphasis added); see also Gelfer v. Pegasystems, Inc., 96 F. Supp. 2d 10, 16 (D. Mass. 2000) (magnitude of revenue overstatements supports strong inference of scienter where restatement corrected $18 million revenue overstatement and $11 million income overstatement); SEC v. DCI Telecomms., 122 F. Supp. 2d 495, 500 (S.D.N.Y. 2000) (alleged overstatements of assets by 40 to 1408 percent, "if true, do not present a case of 'misguided optimism,' but rather show a pattern of knowingly misleading practices that overwhelmingly overstated revenues, made with an intent to defraud"). As the court explained in Rehm v. Eagle Fin. Corp., 954 F. Supp. 1246, 1256 (N.D. Ill. 1997): "The more serious the error, the less believable are defendants[‘] protests that they were completely unaware of [the company's] true financial status and the stronger is the inference that defendants must have known about the discrepancy." Simply put, "the overstatement of significant revenues can support the claim that the defendants acted in a severely reckless manner." Haack v. Max Internet Communications, Inc., No. Civ. A. 3:00-CV-1662-G, 2002 WL 511514, at *7 (N.D.

Tex. 2002). Significantly, each of the cases cited above involved situations where the restatement was a fraction the size of WorldCom's.

Finally, the Section 10(b) Director Defendants' argument that they took quick corrective action which eventually brought the fraud to light is no defense to the fraud claims against them. As an initial matter, the "quick" corrective action taken by WorldCom's Board was preceded by: (a) questions raised by analysts at a conference held on February 7, 2002 (¶ 180); (b) a March 7, 2002 request from the SEC for documents and information concerning a wide range of issues (¶ 182); (c) the March 11, 2002 disclosure by the Dow Jones Newswire about the SEC inquiry (¶ 183); and (d) an internal audit that uncovered the improprieties in the Company's capital expenditures and capital accounts (¶ 102). Clearly, once the directors were put on notice that the SEC, analysts, the media and other outsiders were turning their attention to what was occurring within WorldCom, and once an internal audit had raised flags that could no longer be ignored, the Board knew that it was only a matter of time before someone else would reveal the existence of the fraud. See, e.g., Lernout, 286 B.R. at 38 (taking corrective action once "horse was out of the barn" was too little, too late to defeat inference of scienter).

Indeed, the fact that an internal WorldCom investigation could so readily lead to a "discovery" of the fraud simply reinforces the recklessness with which the Section 10(b) Director Defendants had previously acted. The internal audit investigation, which began in May 2002, uncovered by mid-June 2002 that the Company had engaged in a massive fraud, amounting to at least $3.8 billion in improperly reported earnings. ¶¶ 102-04. The speed with which the fraud was uncovered by this relatively small staff constitutes further evidence of the recklessness of the Section 10(b) Director Defendants.

The Section 10(b) Director Defendants' reliance on this Court's decision in In re Sotheby's Holdings, Inc. Sec. Litig., No. 00 Civ. 1041 (DLC), 2000 WL 1234601 (S.D.N.Y. Aug. 31, 2000) is misplaced. The complaint in Sotheby's contained only "boilerplate allegations" as to the scienter of the financial officer defendants. Id. at *7. Moreover, the financial officer defendants had no responsibilities with respect to the alleged price-fixing machinations by Sotheby's Chairman and CEO. Id. By contrast, as demonstrated above, the Complaint provides detailed allegations which demonstrate that the Section 10(b) Director Defendants (a) had access to information that contradicted their public statements; (b) "failed to review or check information that they had a duty to monitor," and (c) ignored obvious signs of fraud." Id. (citation omitted). For example, the Audit Committee Defendants never investigated the reduction of the merger reserves or the extraordinary capital expenditures, which routinely exceeded budgeted amounts by hundreds of millions of dollars; they allowed Ebbers and Sullivan to weaken the Company's internal controls; and they were specifically aware that WorldCom employees were taking advantage of flaws in the billing system to book phony orders, earning commissions in the process. These specific facts can hardly be deemed "boilerplate," and thus, Sotheby's is distinguishable on its facts.[35]

[35] The Section 10(b) Director Defendants' argument that their lack of scienter is demonstrated by the fact that "no less than six directors purchased WorldCom stock at different times during the class period" (Directors Br. at 23) is illogical and misleading. Many of these purchases appear to be the result of exercises of options, which were subsequently disposed of immediately. See Curnin Aff. Ex. 4 (Areen, 102,076 shares acquired and disposed of an June 7, 2001); Ex. 5 (Bobbitt, 328,263 shares acquired and disposed of on June 7, 2001). Thus, these "purchases" were really sales. Moreover, even if there were certain purchases, this does not negate a strong inference of scienter. See, e.g., Holmes v. Baker, 166 F. Supp. 2d 1362, 1378 (S.D. Fla. 2001); In re Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d 314, 329 (S.D.N.Y. 2001) In re Crown Am. Realty Trust Sec. Litig., 1998 WL 777984, at *4 (W.D. Ind. Nov 2, 1998). Adopting such a bright-line approach would enable corporate insiders to avoid securities fraud liability merely by purchasing stock after initiating securities fraud. See Holmes, 166 F. Supp. 2d at 1378.

For all these reasons, the fraud claims against each of the Section 10(b) Director Defendants should be sustained.

C. The Section 10(b) Claims Against Andersen and Dick Must Be Sustained

The Andersen Defendants do not dispute that the largest accounting fraud in U.S. history occurred on their watch. Rather, Andersen and its audit partner, Melvin Dick, base the bulk of their motion on the argument that the Section 10(b) claim against them (Count VII) does not plead fraud with particularity. Specifically, Andersen contends that the Complaint does not adequately allege why Andersen's unqualified audit reports relating to WorldCom's 1999, 2000, and 2001 financial statements -- in which Andersen certified that it had conducted its audits in accordance with GAAS and that the Company's financial statements were presented in accordance with GAAP -- were false. Andersen Br. at 11-15. Dick also argues that the Complaint does not adequately plead false and misleading statements that are attributable to him. Id. at 18-19. Finally, Andersen contends that the Complaint does not adequately allege that Andersen acted with scienter. Id. at 15-17. As set forth below, each of these arguments fails.[36]

1. The Complaint Adequately Alleges That Andersen Made Materially False and Misleading Statements

Andersen's argument that the Complaint does not adequately allege it made materially false and misleading statements requires little by way of response. WorldCom has admitted that its 1999, 2000, and 2001 reported pretax income, as set forth in its financial statements audited by Andersen, was overstated by nearly $9 billion, and Andersen has withdrawn at least one of its audit opinions, stating

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[36] As noted above, Andersen does not specifically address the claim against it pursuant to Section 11 of the Securities Act (Count III) beyond stating that this claim "should be dismissed for failure to state a claim" and incorporating by reference the legal authorities cited by the Underwriter Defendants. Andersen Br. at 20. For the reasons stated in Point I, this argument is without merit.

that it should no longer be relied upon. ¶ 104. GAAP only permits restatement of prior financial statements based upon information that existed at the time the financial statements were prepared. See APB Opinion No. 20 at ¶ 13; see also In re Telxon Corp. Sec. Litig., 133 F. Supp. 2d 1010, 1026 (N.D. Ohio 2000) (defendants had no basis to dispute that company's financial statements contained material misstatements because "[the company], itself, admitted its prior disclosures were materially misstated when it issued the restatements which gave rise to this litigation"). Thus, Andersen cannot seriously deny that WorldCom's financial statements during the Class Period were materially false when issued and, accordingly, that Andersen's certifications that the financial statements were prepared in accordance with GAAP were also false when made.

In addition, the misstatements in WorldCom's financial statements, the specific GAAP violations, and the factual bases thereof are set forth in extensive detail in the Complaint. ¶¶ 325-42, 370, 427. These allegations meet the particularity requirements of Fed. R. Civ. P. 9(b) and the PSLRA. Contrary to Andersen's assertions, the Complaint states with particularity the "who, what, where, when and why" of the false statements. See Stevelman v. Alias Research Inc., 174 F.3d 79, 84 (2d Cir. 1999). The Complaint sufficiently identifies the particular false statements and who made them -- namely, the false certifications by Andersen that WorldCom's 1999, 2000 and 2001 financial statements were presented in conformity with GAAP and that Andersen's audits were performed in accordance with GAAS. ¶¶ 133-34, 156-57, 187-88. The Complaint also identifies where and when these false statements appeared -- namely, in the opinion letters accompanying the financial statements appearing in, inter alia, WorldCom's 1999, 2000, and 2001 Form 10-Ks, and incorporated with Andersen's consent in the registration statements for the Offerings, the Sky-Tel acquisition and the Intermedia acquisition. ¶¶ 132-33, 154, 156, 185, 187, 199-200, 207-08, 213, 218.

Further, the Complaint provides great specificity as to why WorldCom's financial statements were false and the source of those allegations. See, e.g., ¶¶ 89-92 (setting forth details from the indictments for criminal securities fraud of certain former WorldCom executives and employees); ¶¶ 96, 100 (setting forth facts from internal WorldCom documents obtained by Congress). The Complaint quantifies the precise amount of the accounting irregularities that have been disclosed thus far. ¶ 101. These allegations are sufficient under the standards of Fed. R. Civ. P. 9(b) and the PSLRA to establish that Andersen made materially false statements. See In re Oxford Health Plans, Inc. Sec. Litig., 51 F. Supp. 2d 290, 292-93 (S.D.N.Y. 1999) (denying auditor's motion to dismiss for failure to plead fraud with requisite particularity where the complaint alleged "specific violations" of auditing standards, including falsely reporting that financial statements were prepared in accordance with GAAP, failing to conduct audit with independent mental attitude, and failing to assess control risk).

Likewise, the Complaint sets forth with great specificity why Andersen's representations that it performed its audits in accordance with GAAS were false. The Complaint states the specific auditing standards violated by Andersen and how Andersen's audits violated these standards. ¶¶ 432-33. These allegations are also sufficient to satisfy Fed. R. Civ. P. 9(b) and the pleading requirements of the PSLRA. See Kinney v. Metro Global Media, Inc., 170 F. Supp. 2d 173, 179 (D.R.I. 2001) ("At this stage in the case, the fact that the Plaintiffs specified each statement they alleged to be misleading and specified the reasons why the statements were allegedly misleading is sufficient to sustain their burden [under Fed. R. Civ. P. 9(b) and the PSLRA].") (emphasis in original).[37]

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[37] The cases relied on by Andersen regarding particularity are inapposite. In Ressler v. Liz Claiborne, Inc., 75 F. Supp. 2d 43, 52-53 (E.D.N.Y. 1998), the statements that the plaintiffs alleged to be false were vague positive expressions about how well the company was doing and its positive future prospects. The plaintiffs alleged that facts existed, and were known to defendants, that contradicted these statements. However, the complaint did not identify how the plaintiffs knew these facts or why

2. The Complaint Adequately Alleges Andersen's Scienter

As stated above, scienter may be pleaded by alleging facts that constitute strong circumstantial evidence of Andersen's recklessness, or show that Andersen had the motive and opportunity to commit fraud. The Complaint adequately pleads that both were in play in Andersen's engagement when it came to Andersen's role in the fraud.

Andersen cites a number of decisions for the proposition that mere violations of GAAP or GAAS alone are not enough to plead scienter. Andersen Br. at 12.[38] However, allegations of violations of GAAP and GAAS "may be one of several 'red flags' that support an inference of scienter." In re Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d 314, 334 (S.D.N.Y. 2001); see also Oxford Health, 51 F. Supp. 2d at 295; In re Health Mgt., Inc. Sec. Litig., 970 F. Supp. 192, 203 (E.D.N.Y. 1997); In re the Leslie Fay Cos., Inc. Sec. Litig., 871 F. Supp. 686, 699 (S.D.N.Y. 1995). Moreover, contrary to Andersen's argument (Andersen Br. at 15-16), numerous courts in this District and elsewhere have held that the magnitude of the fraud is relevant to the inference of scienter on the part of auditors:

> In cases where small accounting errors only ripple through the corporate books, a court may conclude, at times even on the face of the complaint, that an accountant's failure to discovery his client's fraud was not sufficiently reckless to sustain a 10b-5 claim. On

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the court should believe them to be true. Id. at 53. At issue in Arazie v. Mullane, 2 F.3d 1456, 1467-68 (7th Cir. 1993), were predictions that the company made concerning future performance, which the plaintiffs contended were unreasonable in light of both public information and unspecified internal documents.

[38] Citing Stevelman v. Alias Research, Inc., 174 F.3d 79 (2d Cir. 1999); Chill v. Gen. Electric Co., 101 F.3d 263, 270 (2d Cir. 1996); SEC v. Price Waterhouse, 797 F. Supp. 1217, 1240 (S.D.N.Y. 1992); Queen Uno Ltd. P'ship v. Coeur D'Alene Mines Corp., 2 F. Supp. 2d 1345 (D. Colo. 1998).

> the other hand, when tidal waves of accounting fraud are alleged, it may be determined that the accountant's failure to discovery his client's fraud raises an inference of scienter on the face of the pleadings.

In re the Leslie Fay Companies, Inc. Sec. Litig, 835 F. Supp. 167, 175 (S.D.N.Y. 1993) (emphasis added); see also Kinney, 170 F. Supp. 2d at 180; Chu v. Sabratek Corp., 100 F. Supp. 2d 815, 820-22 (N.D. Ill. 2000); In re First Merchants Acceptance Corp. Sec. Litig., No. 97 C 2715, 1998 WL 781118, at *11 (N.D. Ill. Nov. 4, 1998) ("[T]he allegations in the complaint, including the magnitude of the misstatements, the specific GAAP and GAAS violations and the 'red flags' together support an inference that Deloitte's audit 'amounted to no audit at all or an egregious refusal to see the obvious or investigate the doubtful.'").

Andersen counters that the magnitude of the fraud is not probative in this case because of the "thoroughness of the concealment" from Andersen. Andersen Br. at 15-16. As an initial matter, the fraud was not concealed from Andersen. Andersen knew in March 2000 that WorldCom was improperly capitalizing line cost expenses. ¶ 96. In In re Livent, Inc. Sec. Litig., 78 F. Supp. 2d 194, 217 (S.D.N.Y. 1999), a case on which Andersen relies in support of this proposition, the fraudulent scheme was actively concealed by hiding relevant contract terms in side letters, id. at 203-04, and redacting or altering the company's books, id. at 206, 208. Here, rather than being concealed, the unsupported and fraudulent adjustments were readily apparent, had Andersen bothered to review WorldCom's general ledger.

Although Andersen cites to the SEC complaint against Myers, Myers' guilty plea, and the indictment against Sullivan and Yates, none of these documents makes any mention of the fraud being concealed from the auditors. Each merely recites that the underlying books of the Company were falsified and that the facts relating to the fraud were not voluntarily disclosed to Andersen by

management, which is a far cry from "concealment." People who commit fraud typically try to hide this fact from view; that is precisely why auditors are charged with responsibilities under GAAS and the PSLRA to take steps to ferret out fraud. See 15 U.S.C.
§ 78-1(a)(2002). Thus, even if it were true that no WorldCom executive revealed the fraud to Andersen, that would not preclude a finding that Andersen acted recklessly and, therefore, does not exculpate Andersen on a motion to dismiss. Leslie Fay, 835 F. Supp. at 175 (rejecting, on motion to dismiss, accounting firm's contention that "it was as much the victim of the fraudulent [accounting] at [the company] as were plaintiffs . . ."). Regardless of whether certain of the participants in WorldCom's scheme tried to hide the fraud from Andersen, the red flags were waving in its face. Indeed, as discussed more fully below, a senior WorldCom official specifically informed Andersen in March 2000 that the Company was committing accounting fraud. ¶ 96.

It does not take 20-20 hindsight to conclude that the type of accounting chicanery involved here would have been easily detected by a GAAS audit. For example, many of the transfers from reserve accounts to income and from expense accounts to capitalized costs were made by adjusting journal entries at the direction of senior management after the end of fiscal quarters, without any supporting documentation. ¶ 432. The sheer audacity of the fraud compelled the Chairman of WorldCom's Board of Directors to comment that Andersen's failure to uncover these accounting irregularities was "inconceivable." ¶ 318.

Facts demonstrating a virtual abrogation of the duty to investigate, i.e., where the audit "amounted to no audit at all," are sufficient to allege recklessness. See In re Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d 314, 333 (S.D.N.Y. 2001) (quotation omitted). This may be shown by allegations that the auditors ignored red flags warning them of potential improper accounting practices.

See Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d at 334 (auditors aware of red flags supporting "the critical allegation that if Andersen were conducting any kind of audit at all, they would have seen the potential problems with the . . . receivables and the need to investigate further"); Oxford Health Plans, 51 F. Supp. 2d at 295 (S.D.N.Y. 1999).

The Complaint adequately alleges Andersen's recklessness, if not actual knowledge, based on its awareness of red flags and its virtually total abdication of its duty to investigate. In particular, in March 2000, Andersen received specific warnings from Steven Brabbs, WorldCom's Director - International Finance & Control, that the Company was not only improperly accounting for line costs but also was doing so deliberately. Brabbs' report included details that should have alerted Andersen to the fact that the accounting was part of a fraudulent scheme, including the facts that the improper accounting for line cost expenses was made by a journal entry after the International Division had closed its books for the first quarter of 2000; the journal entry had been made at the direction of Sullivan; despite repeated requests, Brabbs was given no support or explanation for the entry; and the journal entry had the direct consequence of increasing the International Division's margins at a time when they were declining. ¶ 96(a). The following month, in reviewing the International Division's first quarter results with Andersen's audit partner in the United Kingdom and the Company's senior management, Brabbs noted that the increase in margin trend was "obvious" and told Andersen that they should "request follow through in the United States to ensure appropriate accounting treatment was in place at the global consolidated level." ¶ 96(b). This was passed on to WorldCom executives in the U.S. and Andersen. Id.

This fact alone is sufficient to establish Andersen's scienter because it shows that Andersen had direct knowledge that WorldCom was fraudulently capitalizing line cost expenses in early 2000 -- the

very fraud that was announced more than two years later. See, e.g., In re Health Mgt., Inc., Sec. Litig. 970 F. Supp. 192, 203 (E.D.N.Y. 1997) (allegation of auditors' failure to follow up on letter warning them of accounting improprieties sufficient to allege scienter); In re IKON Office Solutions, Inc. Sec. Litig., 66 F. Supp. 2d 622, 629 (E.D. Pa. 1999) (allegations that auditors were directly informed that corporate CFO was "cooking the books" sufficient to state claim).

Recognizing the obvious implications of Brabbs' statements, Andersen attempts to downplay his revelations by claiming that Brabbs "had not said that the entry was incorrect, only that we had no support for it in International, and that it was appropriate therefore to request justification (or alternatively a corresponding and reversing entry) from the US." See Andersen Br. at 7. In addition to ignoring the principle that all reasonable inferences are to be drawn in plaintiffs' favor, Andersen's explanation is ridiculous.

The context of the statement Andersen quotes is Brabbs speaking to a senior executive in WorldCom's corporate headquarters, Controller Myers, after Myers had expressed that he "was not pleased" that Brabbs had raised the issue of the unsupported journal entry with Andersen. The fact that Myers was critical of Brabbs' divulging this accounting manipulation to Andersen is itself suspicious. In any event, Brabbs' description of his communications with corporate management regarding this journal entry leaves no doubt as to whether Brabbs considered the transaction to be fraudulent. Brabbs clearly states in the June 26, 2002 e-mail that he had told Andersen over two years earlier that the Company's internal controls had been overridden by a post-period journal entry at the direction of the Company's senior management, without any supporting documentation or explanation, which had the effect of causing a sudden increase in the International Division's gross margin. Brabbs goes on to explain that he initially refused to record such a journal entry on his division's books. However, "pressure was

exerted" by U.S. senior finance management and Brabbs was "instructed to make the entry (this pressure we understood was from Scott [Sullivan]'s office specifically)." See Exhibit B to Affidavit of James R. Banko in Support of Arthur Andersen LLP's Motion to Dismiss." (Emphasis in original). Bowing to pressure, but still refusing to record the entry on the International Division's books, Brabbs set up a fictitious "management company" which he pointedly states was "NOT a legal entity." (Brabbs' emphasis). The entry remained on the books of this fictitious company until June 2002.

Andersen also attempts to "spin" the Brabbs e-mail by arguing that it "gives no indication that the $33.6 million of line cost expenses had anything to do with any fraudulent scheme." Andersen Br. at 8. That may be Andersen's preferred view, but it wasn't Brabbs', as a reading of the entire e-mail demonstrates. Brabbs sent his e-mail on June 26, 2002, the day after WorldCom's disclosure that it would take a $3.8 billion restatement. In that context, Brabbs wrote:

> In light of the most serious news that broke yesterday in the U.S., I would like to bring the following matter to your attention. The amount involved is much lower, although certainly sufficiently large to warrant this note, and appears directly related in nature to the accounting irregularities disclosed in the media today.

See Brabbs June 26, 2002 e-mail (emphasis added).

It is difficult to imagine a clearer red flag than the facts recounted in Brabbs' e-mail, and no amount of bobbing and weaving by Andersen can avoid its impact. It is obvious that if Andersen had followed up on Brabbs' warnings and attempted to see if there was any support for this post-period journal entry, it would have learned that, in fact, the entry was fictitious, contrary to GAAP, and part of a much larger pattern of fraudulent accounting throughout WorldCom that had been ongoing for more than a year. It is worth noting that acting on Brabbs' tip when it was received -- in March 2000 --

would have put Andersen in a position to expose the fraud before $17 billion in WorldCom bonds were sold to the investing public.

The Complaint also alleges Andersen's clear motive and opportunity to participate in the fraud. WorldCom was the single most valuable client of Andersen's Jackson, Mississippi office. ¶ 435. Andersen received $16.8 million for services to WorldCom in 2001 alone, including $4.4 million for financial statement audits and quarterly reviews, $7.6 million for tax services, $1.6 million for "non-financial statement audit services," and $3.2 million for all other services. Id. This compensation, of which nearly three-fourths was for non-financial statement audit and review work, provided a strong incentive to turn a blind eye to WorldCom's financial statement manipulations. See Complete Mgt., 153 F. Supp. 2d at 335 ("[D]uring the class period Andersen was paid over $1 million for consulting work. . . . The complaint supports the inference that the desire to maintain the considerable revenues to Andersen's Healthcare Practice Group created incentives for the auditors to seek to please CMI's management at the expense of accuracy and/or completeness").

In response to these allegations, Andersen relies on a line of cases that adopts the hypothesis that an auditor has no motive to deliberately or recklessly overlook a client's fraud because it would be "irrational" for an auditor to put his or her professional reputation at risk to maintain a valuable client. See, e.g., DiLeo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir. 1990).[39] Recent events have

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[39] This hypothesis has never been reflected in the accounting literature, which, to the contrary, demonstrates a serious concern with the possibility that conflicts of interest may compromise an auditor's objectivity. See, e.g., SAS No. 1, Sections 220.01 ("In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors") and 220.03 ("To be independent, the auditor must be free from any obligation to or interest in the client, its management or its owners. Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence"); AICPA Code of Professional Ethics, Rule 102 ("In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her

discredited this hypothesis. The rash of recent accounting scandals at major United States corporations, and the role that outside accountants -- in particular, Andersen -- have played in those scandals was one of the factors that led to the passage of the Sarbanes-Oxley Act in 2002. This Act was predicated in part on a Congressional finding that "the issue of auditor independence is so fundamental to the problems currently being experienced in our financial markets that statutory standards are needed to assure the independence of the auditor from the audit client." S. Rep. No. 107-205, 107 Cong., 2d Sess., at 18 (2002). In light of this finding, Lead Plaintiff submits that this Court should not rely on the now-discredited hypothesis that it would be "irrational" for Andersen to act recklessly in order to maintain a valuable client from which it received millions of dollars in fees annually -- especially in light of the massive fraud in which Andersen was complicit.

3. The Complaint Adequately States a Claim Against Melvin Dick

Dick was Andersen's audit engagement partner on its audit of WorldCom's 2001 financial statements. ¶ 43. As partner-in-charge of the 2001 audit, Dick may be presumed to have issued Andersen's audit opinion. See In re Oxford Health Plans, Inc. Sec. Litig., 187 F.R.D. 133, 142 (S.D.N.Y. 1999) (corporate officers presumed to have issued false statements attributed to company under "group pleading" doctrine); see also In re SmarTalk Teleservices, Inc. Sec. Litig., 124 F. Supp. 2d 527, 545 (S.D. Ohio 2000); In re Baan Co. Sec. Litig., 103 F. Supp. 2d 1, 17 (D.D.C. 2000); In re Health Mgt., Inc., Sec. Litig. 970 F. Supp. 192, 208-09 (E.D.N.Y. 1997). Moreover, as the

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judgment to others") and Article VI, Section 55, paragraph .01 ("Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities.").

engagement partner, Dick reviewed audit workpapers and either became aware of, or but for his recklessness would have become aware of, the numerous red flags available to Andersen in connection with its audits of WorldCom's financial statements. For the foregoing reasons, Dick may be presumed to have been an integral part of Andersen's audits. As a result, the Complaint adequately alleges both false statements and scienter on the part of Dick.

D. The Section 10(b) Claims Against Salomon and Grubman Must Be Sustained

As discussed above, to ensure a steady stream of coveted investment banking services and fees from WorldCom, Salomon and Grubman turned their back on what the public was assured was the integrity of Salomon's underwriting process and the independence of Grubman's research by guaranteeing WorldCom consistently favorable research reports to bolster WorldCom's stock prices; providing WorldCom's top decision makers with de facto bribes in the form of "hot" IPO shares; and extending half a billion dollars in loans to an Ebbers-controlled entity for his personal use. ¶ 12. Even before the Complaint first disclosed the existence of the
Travelers' loans to Ebbers, the Attorney General for the State of New York called this arrangement nothing less than "commercial bribery" ¶ 222.

In their motion to dismiss, the Salomon Defendants do not dispute they knew of, and even participated in, these conflicts of interest or that investors would have thought the conflicts to be material.[40] However, relying on a constricted reading of SEC and NASD regulations, they assert that they had no duty to disclose the conflicts that permeated the relationship -- either in the registration

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[40] Indeed, any such argument would be futile on this motion, because the "determination of materiality requires delicate assessments of the inferences a reasonable shareholder would draw from a given set of facts," and is "generally a question of fact for the jury." SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 863 (2d Cir. 1968); see also Basic v. Levinson, 485 U.S. 224, 239 (1988) (same).

statements for the Offerings or in Grubman's analyst reports -- even though both the Exchange Act and the NASD regulations in effect during the Class Period required them to disclose all material conflicts of interest between Grubman and the companies he covered. They further argue that Grubman's statements and buy recommendations were only opinions that are not actionable under the securities laws. However, it is well-settled that opinions are actionable when, as here, they are subjectively false, made in bad faith, or made without a reasonable basis. Finally, they argue that the Complaint fails to allege loss causation. However, here again, the Complaint clearly alleges that the Analyst Reports inflated the price of WorldCom's securities, and when these conflicts began to be disclosed and Grubman finally downgraded WorldCom -- months before the Company filed for bankruptcy -- the price of WorldCom stock fell dramatically.[41]

As set forth below, each of the arguments that the Salomon Defendants have raised is without merit.

1. Salomon and Grubman Had a Duty to Disclose All Material Conflicts of Interest with WorldCom

Having chosen to make numerous statements to the investing public about WorldCom designed to influence investors' investment decisions, Salomon and Grubman had an affirmative duty to disclose all material facts they knew about WorldCom when they made these statements, including the material undisclosed facts regarding their conflicted relationship with WorldCom. It is well-established that "Rule 10b-5 creates a statutory duty to speak the full truth when a defendant undertakes to say anything." In re Credit Suisse First Boston Corp. Sec. Litig., No. 97-4760, 1998 WL 734365, at *6

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[41] The Salomon Defendants also argue that Lead Plaintiff lacks standing to assert Section 10(b) claims against them with respect to the Offerings because it did not purchase any Notes. For the reasons set forth in Point I, this argument is unavailing.

(S.D.N.Y. Oct. 20, 1998) (internal quotation omitted); see also Rubinstein v. Collins, 20 F.3d 160, 170 (5th Cir. 1994) (although a defendant is not under a duty to disclose "every fact or assumption underlying a prediction, he must disclose material, firm-specific adverse facts that affect the validity or plausibility of . . . the prediction") (emphasis added); First Virginia Bankshares v. Bensons, 559 F.2d 1307, 1314 (5th Cir. 1977) ("Silence, or omission to state a fact, is proscribed only in certain situations; first, where the defendant has a duty to speak, secondly where the defendant has revealed some relevant, material information even though he had no duty (i.e., a defendant may not deal in half-truths)") (emphasis added).

Contrary to the Salomon Defendants' contention (Salomon Br. at 28-34), this duty extends to research analysts and underwriters, and includes the obligation to disclose material conflicts of interest. Numerous judicial and regulatory decisions have specifically held that the antifraud provisions of the Exchange Act impose a duty to disclose material conflicts of interest between analysts and the companies they cover or their management precisely because such information casts doubt on the analysts' objectivity and is material to investors. See, e.g., In re Credit Suisse, 1998 WL 734365, at *6 (defendants had duty to disclose that they held short positions in the stocks of companies on which they issued analyst reports because reasonable investors would have discounted such projections if they knew about analyst's self-interest); In re Enron Corp. Sec, Derivative & ERISA Litig., No. H-01 3624, 2002 WL 31854963, at *112 (S.D. Tex. Dec. 20, 2002) (concealed loan transactions, and other conflicts, between investment banks and Enron should have been disclosed because they "cast doubt on the analysts' objectivity and honesty in evaluation of Enron stock"); In the Matter of Butler, Admin. Proc. File No. 3-7762, 1992 WL 136636 (SEC Rel. No 34-30788, June 8, 1992) (analyst's failure to disclose that he expected to receive compensation from company whose stocks he

recommended violated anti-fraud provisions of the Exchange Act); see also Zweig v. Hearst Corp., 594 F.2d 1261, 1266 (9th Cir. 1979) (duty to disclose conflict of interest in news report arose because reasonable investors might have discounted validity of projections if they knew that author of the report stood to profit if investors heeded the analyst's advice).

Judge Koeltl's decision in Credit Suisse is directly on point here. In Credit Suisse, defendants, an analyst and his employer, conspired to profit on their short positions in certain companies. See 1998 WL 734365, at *1-3. Shortly after acquiring the short positions, defendants issued an analyst report which contained very negative projections about these companies' business prospects and vigorously recommended that investors sell their shares in these companies. Id. Importantly, the reports failed to disclose that defendants had short positions in the stock of these companies and stood to benefit substantially if the investors followed the report's recommendation. Id. The court held that defendants had a duty to disclose that they held short positions in the companies because (1) they had a duty to speak the full truth when they issued the report and (2) their failure to disclose that market prices were being artificially depressed operated as deceit on the market. Id. at *6 (citing U.S. v. Regan, 937 F.2d 823, 829 (2d Cir. 1991), cert. denied, 504 U.S. 940 (1992)). The court further held that the complaint sufficiently alleged that the information about the short positions was material, because "a reasonable fact-finder could find that such information would have 'significantly altered' the total mix of information available to investors." Id. at *7 (relying on Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988) (information is material when "there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available.")); see also SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1466 (2d Cir. 1996) (same).

Similarly, the NASD regulations in effect during the Class Period required disclosure of Salomon's and Grubman's conflicted relationship with WorldCom. NASD Conduct Rule 2210 sets out disclosure requirements with respect to certain public communications (including analyst reports) by a registered broker-dealer like Salomon.[42] During the Class Period, NASD Manual, Conduct Rule 2210(d)(1)(A) provided as follows:

> All member communications with the public shall be based on principles of fair dealing and good faith and should provide a sound basis for evaluating the facts in regard to any particular security or securities or types of security, industry discussed or service offered. No material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the communication to be misleading.

NASD Manual, Conduct Rule 2210(d)(1)(A) (2000) (emphasis added). In addition, NASD Conduct Rule 2110 in effect during the Class Period required members to observe high standards of commercial honor and just and equitable principles of trade. See NASD Manual, Rule 2110. Numerous NASD regulatory decisions have held that the NASD Conduct Rules referenced above specifically require disclosure of conflicts of interest between a broker-dealer and a company, again because such information is material to investors. See, e.g., In the Matter of Kunz, Compl. No. C31960029, 1999 WL 1022141, at *12 (N.A.S.D.R., July 7, 1999) (failure to disclose a consulting relationship between the representative of a broker-dealer and the company violated NASD Conduct Rule 2110; "it strains credibility to suggest that a reasonable investor would not have viewed a potential conflict of interest like that ... as having altered the total mix of information") (emphasis added); In the Matter of Shaughnessy, Admin. Proc. File No. 3-9332, 1998 WL 406823 , at *2 (S.E.C. Release No. 34-40244, July 22, 1998) (representative of registered broker-dealer violated NASD Conduct Rule 2110

[42] The Salomon Defendants concede that they were required to disclose all information mandated by the NASD Manual. See Salomon Br. at 30.

by failing to disclose to his customers, to whom he was recommending certain stock, that he was receiving compensation from a stock promoter to sell the stock).

Here, as in Enron, Credit Suisse and the other authorities cited above, disclosure of the material conflicts of interest that permeated the WorldCom-Salomon relationship would have cast doubt on Grubman's objectivity and honesty. It clearly would have been material to WorldCom investors to know: (a) the reason Grubman was writing such positive reports was that he hoped to land lucrative investment banking fees for Salomon (which would, in turn, have a direct effect on his own compensation); (b) at the same time they were touting the stock, Salomon and Grubman were further ingratiating themselves with the "analyzed" company by allocating millions of dollars' worth of hot IPO shares to WorldCom's most senior officers and directors; and (c) Salomon, Grubman and Salomon's corporate sibling within Citigroup (Travelers) were focusing particularly lavish attention on the key WorldCom decision maker, Ebbers, by arranging a half-billion dollar loan to Joshua Timberlands, an entity controlled by Ebbers. Indeed, throughout most of the Class Period, Grubman consistently held a "buy" or "strong buy" rating on WorldCom (¶ 263) without disclosing the most essential information necessary for a reasonable investor to evaluate the strength of Grubman's ratings and investment recommendations -- the fact that Grubman and Salomon were paid tens of millions of dollars to make these statements. Similarly, Grubman extolled the virtues of WorldCom's business and management without disclosing that he was in effect an investment banker and a WorldCom insider, who sat in on key strategic meetings of WorldCom's Board and had such a close personal relationship with Ebbers that he attended Ebbers' wedding. ¶ 246. This deliberate failure to disclose the true nature of the relationship between Salomon, Grubman and WorldCom rendered the statements made in the analysts

reports materially false and misleading. See Credit Suisse, 1998 WL 734365, at *7; Enron, 2002 WL 31854963, at *112.

After contending that they had no duty to disclose the conflicts, Salomon and Grubman argue that, even if they did have such a duty, they sufficiently disclosed these conflicts by including a boilerplate disclaimer at the end of each report which "revealed" that within the prior three years, Salomon had served as a manager of a public offering of WorldCom securities, and that "from time to time" Salomon had performed investment banking services for WorldCom. See Salomon Br. at 31. This argument in fact misses the point. The Complaint does not allege that the analyst reports were false because they failed to disclose that Salomon served -- at some unspecified points during the preceding three years -- as WorldCom's investment bankers. Rather, the Complaint alleges that the analyst reports were false because, among other things, they failed to disclose that Grubman was writing positive reports about WorldCom in order to secure additional investment banking business for Salomon and all the other, undisclosed benefits for himself and Ebbers.

Moreover, the so-called disclosures that the Salomon Defendants tout in their brief were mere boilerplate. Under the "bespeaks caution" doctrine, "the inclusion of general cautionary language regarding a prediction does not excuse the alleged failure to reveal known material or adverse facts." Rubinstein v. Collins, 20 F.3d 160, 171 (5th Cir. 1994); see also Credit Suisse, 1998 WL 734365, at *7 ("if a party is aware of specific dangers or cause for concern, the party may not rely on a generic disclaimer in order to avoid liability under [the bespeaks caution doctrine]"); Enron, 2002 WL 31854963, at *112 (investment bank's boilerplate disclosures were insufficient in light of specific transactions that potentially gave rise to significant conflicts of interest). Here, the Salomon Defendants do not dispute that the conflicts of interest alleged in the Complaint were facts that were known to them

at the time the reports were issued and could have been material to investors. Accordingly, the "disclaimer" -- which does not even address any of the specific conflicts alleged in the Complaint -- does not insulate defendants from liability.

The Salomon Defendants also had an obligation to disclose the conflicts in the registration statements for the Offerings. An underwriter's duty to disclose any material relationship with the issuer is dictated by (1) Item 508 of Regulation S-K, which in relevant part provides that a registration statement must disclose material relationships between an underwriter and a registrant and state the nature of such relationship, and (2) an underwriter's obligation to ensure and verify the correctness of a registration statement. See 17 C.F.R. § 229.508 (2002); see also Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341, 370 (2d Cir. 1973) (there is no greater responsibility in our self-regulatory securities system than that given to underwriters to verify the accuracy of published materials); In re A.J. White & Co., Admin. Proc. File No. 3-4390, 1975 SEC LEXIS 1564 at *44-45 (SEC Release No. 11436, May 21, 1975) ("an underwriter has a 'special duty to ascertain and disclose the true facts not only at and during the initial offering but also in the period thereafter when it was conducting an active retail sales campaign.") (quoting Heft, Hahn & Infante, Inc., File No. 8-7475, 1963 WL 63645 (SEC Release No 34-7020, Feb. 11, 1963) (emphasis added)).

Consistent with this legal framework, numerous courts have held that a relationship between an issuer and an underwriter that casts doubts on the integrity of the underwriting process must be disclosed in the offering documents. See SEC v. Scott, 565 F. Supp. 1513, 1527 (S.D.N.Y. 1983) (kickback arrangement between issuer and underwriter is material and should be disclosed because it "raises an inherent conflict of interest"); SEC v. Softpoint, Inc., 958 F. Supp. 846, 863 (S.D.N.Y. 1997) (same); Jenny v. Shearson, Hammill & Co., No. 74-3526, 1981 WL 1611, at *5 (S.D.N.Y.

March 20, 1981) (failure to disclose underwriter's business relationship with issuer may be material omission); In the Matter of Lazard Freres & Co., Admin. Proc. File No. 3-9495, 1997 WL 742097, at *5 (S.E.C. Release No. 33-7480, Dec. 3, 1997)
(certain payments to financial advisors and outside consultants need to be disclosed in offering documents because existence of such payments casts doubt on integrity of offering process).

As alleged in the Complaint, Salomon's material conflicts of interest vis-a-vis WorldCom certainly cast doubt on the integrity of Salomon's underwriting process with respect to the Offerings. As alleged in the Complaint, there were numerous red flags that should have put all underwriters on notice of the underlying fraud at WorldCom. See, e.g., ¶¶ 380-88. On top of all that, Salomon's underwriting was clearly reckless, given Grubman's insider position at WorldCom and Salomon's knowledge of its own serious conflicts with its responsibilities as an underwriter. See, e.g., ¶¶ 389-90. By failing to follow up on the "red flag" warning signs, or disclose in any meaningful sense its own conflicted situation, Salomon -- either knowingly or recklessly -- failed to fulfil the expectations of reasonable investors who looked to Salomon's supposed integrity, expertise and experience in connection with its underwriting process. Such investors clearly would want to know that Salomon was in "cahoots" with WorldCom and its executive officers and therefore had an incentive to cover up -- or at least not to uncover -- WorldCom's financial problems. Thus, Salomon may be found liable under Section 10(b) for the materially false and misleading statements, as well as the material omissions, in the Offerings' registration statements, as well as the analyst reports.[43]

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[43] Ebbers also argues that neither he nor WorldCom, the Company he controlled, had any duty to disclose these conflicts of interest in the registration statements issued in connection with the Offerings. Ebbers Br. at 25-27. For the reasons set forth herein, this is incorrect. Clearly, Ebbers -- as WorldCom's CEO and the person who had actual knowledge of, and participated in the conflicted relationship -- had coterminous disclosure obligations with the Company. See 17 C.F.R. §

2. Grubman's Buy Recommendations and Other False Statements Are Actionable

The Salomon Defendants also contend that they cannot be held liable for the "buy" recommendations and other wildly positive statements touting WorldCom set forth in the false analyst reports because those statements supposedly constitute generic statements of optimism and "expressions of opinion" that as a matter of law are not actionable. See Salomon Br. at 20. This is incorrect.

As an initial matter, as noted above, Grubman was the most influential analyst on Wall Street. ¶ 236. As set forth below, the price of WorldCom stock typically rose immediately after Grubman issued his WorldCom reports, and when Grubman finally downgraded WorldCom in April 2002, the stock lost nearly half its value in just two trading days, on record volume. The notion that his "buy" recommendations and other statements urging investors to buy WorldCom stock were not material, too vague, or not the type of statements upon which investors would rely when making their investment decisions is ludicrous, and directly contradicted by the facts and law.

The recently decided case of Bamberg v. SG Cowen, No. Civ. A. 02-10304, 2002 WL 31757468 (D. Mass. Dec. 9, 2002), which involves another well-publicized accounting fraud, is instructive. In Bamberg, plaintiffs were investors who sold their business to Lernout & Hauspie Speech

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229.508(a). Ebbers' other argument -- that these conflicts were simply business as usual between a large company like WorldCom and a prominent investment banker -- is not only not supported by the facts, it raises questions of fact which may not be considered on this motion. Indeed, what Ebbers argues in essence is that, because other companies were violating the securities laws, it was appropriate for WorldCom to do so as well. Finally, Ebbers goes to great lengths to argue that the Complaint does not sufficiently allege the elements of a conspiracy between WorldCom and the SSB Defendants. Ebbers Br. at 27-36. This argument is frivolous. The Complaint does not attempt to, and does not need to, plead a claim of conspiracy. Rather, the Complaint asserts a claim under Section 10(b) of the Exchange Act and Section 11 premised on the fact that the analyst reports and registration statements omitted to disclose material information.

Products, N.V. ("L&H") in exchange for L&H stock. Shortly after the deal closed, L&H restated its financial statements for a three year period, wiping out nearly three-quarters of the revenue the company had booked during this period; the senior officers of the corporation were arrested and charged with fraud; and the company filed for bankruptcy, rendering the stock worthless. Plaintiffs brought an action alleging violations of Section 10(b) against Cowen, which served as L&H's investment banker and had issued a series of analyst reports prior to the transaction promoting L&H as a good investment opportunity and a strong buy. As these defendants do here, Cowen argued that its analyst reports describing L&H as a "strong buy" could not give rise to liability as a matter of law, because they were immaterial expressions of optimism and mere opinions upon which investors would not rely. The court rejected this argument, holding that the strong buy recommendations "presented by respected outside investment analysts are precisely the kind of hard information that a reasonable investor could find important to the total mix of information." Id. at *3 (citations omitted).

In this Circuit, opinions are actionable if they are made in bad faith or lack a reasonable basis. See In re IBM Corp. Sec. Litig., 163 F.3d 102, 107 (2d Cir. 1998); Cromer Fin. Ltd. v. Berger., 205 F.R.D. 113, 128 (S.D.N.Y. 2001) (Cote, J.). Here, the Complaint sufficiently alleges that the statements made in the analyst reports were made in bad faith and lacked a reasonable basis. Indeed, the NYSCRF alleges that Grubman issued his reports not because he believed in the merits of WorldCom as an investment, but because his annual compensation depended on the amount of investment banking business he delivered to Salomon, and WorldCom was his and Salomon's cash cow. ¶ 11. The Complaint further alleges that, in exchange for WorldCom agreeing to funnel its investment banking business to Salomon, Salomon and Grubman promised WorldCom glowing analyst reports which they knew would inflate the price of WorldCom securities and allow the Company to

continue to pursue the acquisitions that were critical to its business plan and which enabled it to camouflage the deterioration in its business. ¶¶ 11, 247. It was this quid pro quo relationship that led Attorney General Spitzer to render his "commercial bribery" comment. ¶ 222. Under these circumstances, telling the investing public that you have reached your "opinion" on the basis of objective criteria is the epitome of bad faith. See Credit Suisse, 1998 WL 734365, at *5 (statements about certain companies were made in bad faith because they were made "as part of a scheme to drive down the price of [certain companies'] stock and thereby to benefit the defendants").

The Complaint also alleges ample facts to demonstrate that Grubman lacked a reasonable basis for the opinions he expressed in the analyst reports. In his reports, Grubman stated that he was recommending WorldCom because it had the best assets and management in the business. ¶¶ 261, 262, 263. Lead Plaintiff alleges that this was a lie and that Grubman actually recommended WorldCom because of WorldCom's investment banking business and his own wallet. The Complaint is replete with allegations -- citing specific internal e-mails that Grubman wrote -- which show that Grubman routinely lied about the prospects of the telecommunications companies he followed, referred to companies on which he publicly had buy recommendations as "pigs" in private communications, and maintained "buy" recommendations on companies which he knew should be downgraded because they were investment banking clients. ¶¶ 240, 242. Most significantly, the Complaint further alleges that Grubman actually changed his method for analyzing WorldCom in a way that obscured WorldCom's growing cash flow problems. ¶ 275. As noted above, Grubman was well-positioned to access and evaluate the numbers pertaining to those issues, having effectively become a corporate insider, with access to WorldCom executives and corporate documents. ¶ 238.

Grubman also continuously downplayed the impact that material adverse events would have on WorldCom. For example, on April 27, 2000, Grubman recommended that investors buy WorldCom stock because of the impact that the pending merger with Sprint would have on the Company, telling investors that they should "take advantage of nervousness over the [proposed merger] <u>that is going to get done</u>." ¶ 260. Then, when the deal collapsed, he assured investors that it wouldn't "disrupt co's ability to grow at a double-digit rate for top & bottom line growth." ¶ 261. In January 2001, Grubman argued that news of massive lay-offs at WorldCom showed a "top management team" focused on "achieving results." ¶ 263. After the events of September 11, Grubman strongly reiterated his buy recommendation, telling investors that WorldCom was uniquely positioned to capitalize on the tragic events. ¶ 267. When the SEC announced its inquiry into WorldCom's accounting in early 2002, Grubman downplayed the inquiry and dismissed it as "boilerplate." ¶ 269. Grubman continued to recommend WorldCom until April 2002, when the stock was trading at only $6 per share.

Finally, contrary to the Salomon Defendants' assertion (Salomon Br. at 21), Grubman's opinions were not always in line with other analysts' opinions. In fact, Grubman was so interested in ensuring WorldCom's good fortune that when Scott Cleland, an analyst at Legg Mason Precursor Group, issued a negative report on WorldCom, Grubman called several of Cleland's clients to criticize Cleland's analysis and reinforce Grubman's own opinions. ¶ 272.

3. The Complaint Adequately Alleges That Salomon and Grubman Acted with Scienter

In arguing that the Complaint fails to plead their scienter, Salomon and Grubman ignore many of the allegations of the Complaint. Specifically, while these Defendants argue (incorrectly) that there are no allegations that they knew about the accounting fraud at WorldCom, they fail to address the

allegations that establish that they knew that there were material conflicts of interest that permeated the WorldCom-Salomon relationship, yet failed to disclose them. The Salomon Defendants do not dispute that Salomon had a corporate policy of awarding WorldCom's most senior executives kickbacks in the form of millions of dollars worth of shares of hot IPOs; that Grubman's compensation depended on the amount of investment banking business he delivered to Salomon; that Salomon's corporate sibling, Travelers, secretly loaned Ebbers hundreds of millions of dollars for his personal use; or that Grubman was in fact a WorldCom insider and investment banker who attended meetings of WorldCom's Board of Directors. ¶¶ 11, 12, 238. These Defendants also do not dispute that they knew that these facts created a material conflict of interest.[44] Indeed, in August 2002, Salomon was constrained to concede to the Congressional Committee investigating the fraud at WorldCom that "some allocations [of hot IPOs] to corporate officers or directors were sufficiently large as to raise questions about the appearance of conflicts," and senior Salomon executives have now acknowledged that they knew

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[44] In his Interim Report, Examiner Thornburgh also noted that, even at a preliminary stage of the investigation, he had concluded that the conflicts of interest between WorldCom, Salomon, Grubman, and Ebbers went deeper than what had been earlier revealed. With respect to the allocation of hot IPO shares to WorldCom officials, the Report stated that the "lucrative IPO allocations created the appearance that [Ebbers] was trading corporate business for private gain because Mr. Ebbers played a primary role in directing investment banking business to Salomon." Report at 87. With respect to Grubman's role as WorldCom's primary supporter, the Report noted that "Mr. Grubman's behavior seems to have departed from the role of an independent securities analyst. . . ." Report at 97. Specifically, the Report determined that Grubman routinely attended key Board meetings, including those to discuss the WorldCom-MCI merger and the WorldCom-Sprint merger. Report at 98. At those meetings, Grubman acted as a "financial advisor" to the Company, advising it on the impact that these transactions would have on WorldCom's "growth metrics and pro forma earnings." Report at 98. The Examiner also uncovered evidence that Grubman would tell management what questions he would ask in advance of conference calls with other analysts, so that they had time to prepare and could provide a favorable response. Id. According to the Report, Grubman had even gone so far as to run interference for the Company on these calls with by "prepping" WorldCom executives on how to handle difficult topics prior to those calls. Id.

Salomon's research was "basically worthless." ¶ 231. There is simply no colorable dispute on this motion that the Complaint adequately pleads scienter with respect to the conflicts of interest.

The Complaint also sufficiently alleges that both Grubman and Salomon knew, or but for their recklessness should have known, about WorldCom's financial fraud. First, the Complaint alleges with particularity that Salomon and Grubman had an extremely close, lengthy and lucrative relationship with WorldCom and its management which afforded them access to inside information about the Company. See, e.g., ¶¶ 228, 244-45, 446. See Novak v. Kasaks, 216 F.3d at 308 (scienter sufficiently pled where plaintiffs alleged that defendants had access to information which contradicted defendants' public statements); Bamberg, 2002 WL 31757468, at *3 ("the extremely close, lengthy and lucrative relationship between SG Cowen and [the company]" was a significant factor in concluding that complaint sufficiently pled scienter as to analyst).

Second, as more fully explained above, the sheer magnitude of WorldCom's financial restatements, currently amounting to more than $9 billion, raises a strong inference that Salomon and Grubman knew or were reckless in not knowing about WorldCom's true financial condition. It would be difficult to conceive of anyone better qualified, or better connected, than Jack Grubman when it came to peeling back the numbers to detect what was really happening at this particular telecommunications company.

Finally, the Complaint also alleges that Grubman changed his analysis with respect to WorldCom to paper over the deep financial crisis looming over the Company. ¶¶ 275-78.[45] These

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[45] The Salomon Defendants invite the Court to engage in an analysis on the merits of the Complaint's allegations that Grubman changed his analytical model to cover WorldCom's escalating cash flow deficit (Salomon Br. at 18 n.12) -- an invitation which the Court should reject in considering the motion to dismiss. See, e.g., ESI, Inc. v. Coastal Power Prod. Co., 13 F. Supp. 2d 495, 499 (S.D.N.Y. 1998) (denying motion to dismiss, holding that "[i]t was for a jury to determine" the

facts, if taken as true, are certainly sufficient to raise a strong inference that Grubman knew that WorldCom was a house of cards and desperately tried to prevent its fall. See, e.g., Bamberg, 2002 WL 31757468, at *3 (Cowen's assistance in fending off concerns raised by The Wall Street Journal about L&H's accounting prior to restatement was another factor creating strong inference of scienter).

The Complaint also pleads that Salomon and Grubman had motive and opportunity to orchestrate the scheme to defraud because they both stood to gain tremendous pecuniary benefits from such an arrangement and had the ability to manipulate the financial markets. See Credit Suisse, 1998 WL 734365, at * 6 (plaintiff sufficiently alleged motive where complaint alleged that defendants held short positions in certain stocks and issued sell recommendations in order to drive down price of stock and profit from their investment); see also In re Independent Energy Holdings PLC Sec. Litig., 154 F. Supp. 2d 741, 766 (S.D.N.Y. 2001) (where complaint alleges that company stood to gain financial benefits from the fraud, including escaping liability on substantial line of credit it had guaranteed, motive was sufficiently alleged).

WorldCom was the type of client Salomon could not afford to lose. The Company was the second largest telecommunications enterprise in the world, with a market capitalization at its peak of more than $180 billion and, most importantly for the Salomon Defendants, an unsurpassed appetite for

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appropriate interpretation of documents at issue); see also Riggs v. Clark County School Dist., 19 F. Supp. 2d 1177, 1180 (D. Nev. 1998) (denying motion to dismiss because resolution of conflict over meaning of statements "is a question of fact for the jury"). Although the Salomon Defendants do not dispute that Grubman changed his analytical model from a "discounted free cash flow" method to a "cash earnings" method, they argue that the change actually occurred in mid-1999 -- which ends up being earlier in the Class Period than the Complaint alleges. More importantly, the Salomon Defendants do not dispute the allegation that when Grubman changed his analytical model for WorldCom, he did not do so for any of the other telecom stocks he covered. ¶ 275. That allegation alone is sufficient to raise an inference that Grubman recognized that something occurring at WorldCom required him to alter his analysis of its financial health.

acquisitions, which generated staggering investment banking fees. ¶ 250. Salomon's fee for the WorldCom-MCI merger alone was approximately $33 million, and Salomon earned at least $107 million from investment banking services it provided to WorldCom. ¶ 250. Both Grubman and Salomon knew that if the price of WorldCom stock fell, WorldCom would not be able to pursue acquisitions or conduct offerings of securities, and that the well of investment banking fees from which these defendants drank would run dry.

The Salomon Defendants had yet another compelling motive -- unique to Salomon and Citigroup's Travelers -- to inflate WorldCom's stock price. As noted above, Travelers loaned Ebbers several hundred million dollars during the Class Period, at least part of which was secured by WorldCom stock. ¶ 12. The Salomon Defendants thus had a direct financial motive for ensuring that WorldCom stock remained high, because if the stock declined, Travelers' collateral would become worthless. See Suez Equity Investors v. Toronto Dominion Bank, 250 F.3d 87, 100 (2d Cir. 2001) ("as creditors or equity holders in the Company, [defendants] had a motive for fraud based upon their own at-risk investments"). Under these circumstances, the Complaint more than adequately pleads scienter as to Salomon and Grubman.[46]

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[46] Salomon and Grubman also argue that the Complaint does not plead fraud with the particularity required by Fed. R. Civ. P. 9(b) because Plaintiffs do not "identify the bases for all of their allegations that the Salomon Defendants knew that WorldCom overstated its financial statements." Salomon Br. at 18. Defendants are incorrect. See Novak v. Kasaks, 216 F.3d at 313 (holding that under Section 10(b) there is "nothing in the caselaw of this circuit that requires plaintiffs to reveal confidential sources" and that "plaintiffs need only plead with particularity sufficient facts to support" their basis for alleging statements to be false and misleading) (emphasis in original); In re APAC Tel., Inc. Sec. Litig., No 97 Civ. 9145 (BSJ), 1999 WL 1052004, at *6 (S.D.N.Y. Nov. 19, 1999) (Fed. R. Civ. P. 9(b) does not require that the pleading contain detailed evidentiary matter) (internal quotation omitted). In any event, the Complaint does adequately plead the sources for the allegations, whether they be in the WorldCom admissions, the pleadings filed in the criminal and SEC actions, comments and reports from the Congressional inquiries, the New York State Attorney General investigation, or interviews with witnesses.

4. The Complaint Adequately Alleges That the Conduct of Salomon and Grubman Proximately Caused Plaintiffs' Losses

Salomon and Grubman assert that the NYSCRF has "failed to plead facts necessary to establish loss causation." Salomon Br. at 3. This is incorrect for at least two reasons. First, the Complaint specifically alleges that their misrepresentations and omissions artificially inflated the price of WorldCom's securities during the Class Period. Second, once these misrepresentations and omissions became known, the value of WorldCom's securities declined. Either showing is sufficient to meet the pleading standard on a motion to dismiss.

"It is settled that causation under federal securities laws is two-pronged: a plaintiff must allege both transaction causation, i.e., that but for the fraudulent statement or omission, the plaintiff would not have entered into the transaction; and loss causation, i.e., that the subject of the fraudulent statement or omission was the cause of the actual loss suffered." Suez Equity Investors v. Toronto-Dominion Bank, 250 F.3d 87, 95 (2d Cir. 2001).[47] "To establish loss causation, a plaintiff must show that the economic harm that it suffered occurred as a result of the alleged misrepresentations. We have on occasion likened loss causation to the tort concept of proximate cause, because, similar to proximate cause, in order to establish loss causation, a plaintiff must prove that the damage suffered was a foreseeable consequence of the misrepresentation." Citibank, N.A. v. K-H Corp., 968 F.2d 1489, 1495 (2d Cir. 1992).

These standards are amply met here.

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[47] Salomon and Grubman do not challenge that the Complaint adequately pleads transaction causation. Cf. Cromer Fin. Ltd., 205 F.R.D. at 128 ("[u]nder the [fraud on the market theory], an individual plaintiff need not show that he actually read or heard a misrepresentation . . . he is presumed to have relied on it by virtue of his reliance on a market that fully digests all available material information about a security and incorporates it into that security's price").

a. The Complaint Sufficiently Pleads Loss Causation by Alleging That the Price of WorldCom Securities Was Inflated During the Class Period by Salomon's and Grubman's Material Misrepresentations and Omissions

As courts in this District have noted, the Second Circuit "has yet explicitly to address the issue" of how the loss causation or "proximate causation requirement is to be met in cases in which the plaintiff proceeds under a fraud on the market theory." Fellman, 2000 WL 489713, at *12; see also Cromer Fin. Ltd., 205 F.R.D. at 128 n.18. However, other courts which have considered the issue have consistently held that the loss causation element of a securities fraud claim under Section 10(b) and Rule 10b-5 may be satisfied by alleging that the stock price was inflated as a result of the defendants' misrepresentations and omissions. In Knapp v. Ernst & Whinney, 90 F.3d 1431, 1437 (9th Cir. 1996), the Ninth Circuit rejected defendant's argument that the trial court should have instructed the jury to find loss causation only "if Ernst & Whinney's 'misrepresentation or misleading omissions . . . were the reason for the [stock's] decline in price.'" Rather, the appellate court upheld the district court's instruction that the jury could "find loss causation if it found that there were material misrepresentations and/or omissions which caused the market price of [the] stock purchased by the class members to be higher than it would have been if all the true facts were known or if you find that [the Company's] stock would not have been issued." Id. at 1437-38. In affirming, the Ninth Circuit unambiguously held that the jury instruction was a proper standard for judging loss causation: "[i]n a fraud-on-the-market case, plaintiffs establish loss causation if they have shown that the price on the date of purchase was inflated because of the misrepresentation." Id. at 1438.

Other courts have held that the loss causation requirement was met under similar circumstances. See, e.g., In re Control Data Corp. Sec. Litig., 933 F.2d 616, 619-20 (8th Cir. 1991) ("Causation lies in the fact that the plaintiff relied on the market price of the security as an indicator of the future value of

the stock. To the extent that the defendant's misrepresentations artificially altered the price of the stock and defrauded the market, causation is presumed."); Scattergood v. Perelman, 945 F.2d 618, 624 (3d Cir. 1991) (plaintiffs adequately pled loss causation by alleging that "the market price paid by the plaintiffs exceeded the value of the stock at the time of purchase based on true facts"); Picard Chem. Inc. Profit Sharing Plan v. Perrigo Co., 940 F. Supp. 1101, 1126 (W.D. Mich. 1996) (to adequately plead loss causation, "plaintiffs may allege that the price of [the company's] common stock was artificially inflated by defendants' materially misleading statements when plaintiffs made their respective purchases" and characterizing the pleading burden as "minimal").

As discussed above, Grubman and Salomon made numerous material misrepresentations and omissions that artificially inflated the price of WorldCom's securities during the Class Period. Put simply: when Jack Grubman spoke, the market listened. WorldCom's stock price typically rose the next trading day after Grubman published a report. For example, after Grubman published his August 20, 1999 report telling investors to "load up the truck," the stock climbed $1.73 to close at $49.18. ¶ 258. On February 8, 2000, the day after Grubman published a report calling WorldCom's stock "absurdly cheap" and heralding the company's "sexy" assets, the stock jumped $2.83 to close at $48.96. ¶ 259. The day after Grubman's June 27, 2000 report, which assured investors that the likely collapse of the Sprint merger was a positive development for WorldCom, the stock soared $4.69 to close at $42.83. ¶ 261.

Further evidence that Grubman's reports inflated the price of WorldCom stock can be seen in the reaction of the stock when Grubman finally and belatedly downgraded his rating on WorldCom on April 21, 2002. ¶ 270. Over the next two trading days, the price of WorldCom stock fell from $5.98

to $3.41 -- a drop of 43% -- on enormous volume. Thus, Grubman's analyst reports artificially inflated the value of WorldCom's stock. ¶ 256.[48]

b. The Complaint Sufficiently Pleads Loss Causation Because Salomon's And Grubman's Fraud Contributed to Plaintiffs' Damages

Even if the Court were to determine that the Complaint must do more than allege that WorldCom's stock was artificially inflated by the Salomon Defendants' material misstatements and omissions, Lead Plaintiff has still met its pleading burden. Under the standard established by the Second Circuit, "whether loss causation has been alleged turns upon a question of proximate cause: was the damage complained of a foreseeable result of the plaintiff's reliance on the fraudulent misrepresentation?" Weiss v. Wittcoff, 966 F.2d 109, 111 (2d Cir. 1992); see also Citibank, N.A. v. K-H Corp., 968 F.2d at 1495 (plaintiff establishes loss causation by pleading that its injury was a "foreseeable consequence of the transaction").

Here, the premise underlying the Salomon Defendants' loss causation argument -- that the Complaint "do[es] not allege (and cannot allege) that the public disclosures of any information purportedly omitted from Salomon's Analyst Reports caused a decline in WorldCom's stock's price and thus resulted in plaintiffs' alleged losses" because by the time these disclosures came to light, WorldCom had already made its first restatement announcement and filed for bankruptcy (Salomon Br. at 27) -- is factually incorrect. Indeed, there was widespread media coverage of allegations of the

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[48] This is true notwithstanding the Defendants' argument that "[t]he price of WorldCom's stock declined almost continuously during the proposed class period despite the recommendations by Grubman. . . ." Salomon Br. at 14 (emphasis in original). Although they cite one example in which WorldCom stock fell the day after Grubman issued an analyst report (id. at 27-28), they fail to disclose that, after Grubman published the vast majority of the analyst reports discussed in the Complaint, WorldCom's stock price rose the very next trading day. While the stock did decline during the Class Period, there is little doubt that the stock would have traded even lower had the truth about Grubman's recommendations been revealed.

conflicts of interest between Salomon and WorldCom and of the multiple governmental investigations that were launched into Salomon's and Grubman's business practices beginning in February 2002.[49] These disclosures were made four months before WorldCom announced its first restatement of $3.8 billion on June 25, 2002 and five months before WorldCom filed for bankruptcy protection on July 21, 2002. ¶¶ 68, 104.

On February 27, 2002, The New York Times reported that two former Salomon brokers had filed a counterclaim against Grubman and Salomon in a NASD arbitration case, alleging that Grubman had issued overly bullish reports about WorldCom, and that Salomon had failed to disclose the inherent conflict of interest in Grubman's reporting. See Salomon Analyst Is Sued by Brokers Over Bullish Ratings, N.Y. Times, Feb. 27, 2002, available at www.nytimes.com.

The next day, The Wall Street Journal reported that Grubman's dual roles at Salomon as analyst and "deal broker" created a "tremendous conflict" and that Salomon was considering "downgrading" Grubman's role at the company. See Randall Smith, Deborah Soloman and Charles Gasparino, Salomon May Downgrade Jack Grubman, As the Telecom Analyst's Dual Roles Grate, Wall St. J., Feb. 28, 2002, available at www.wsj.com. On April 12, 2002, The Wall Street Journal reported that New York Attorney General Spitzer was expanding his investigation into Wall Street analysts to include

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[49] In deciding a motion under Rule 12(b)(6), the Court may consider "facts stated on the face of the complaint and in documents appended to the complaint or incorporated in the complaint, as well as [ ] matters of which judicial notice may be taken." Automated Salvage Transp., Inc. v. Wheelabrator Envtl. Sys., Inc., 155 F.3d 59, 67 (2d Cir. 1998). Pursuant to Fed. R. Evid. 201, the Court may take judicial notice of newspaper articles in deciding a Rule 12(b)(6) motion to dismiss. See Manufacturers Life Ins. Co. (U.S.A.) v. Donaldson, Lufkin & Jenrette Sec. Corp., 99 Civ. 1944 (NRB), 2000 WL 709006, at * 1 n.1 (S.D.N.Y. June 1, 2000); Cerasani v. Sony Corp., 991 F. Supp. 343, 354 n.3 (S.D.N.Y. 1998) (taking judicial notice of widespread newspaper coverage and collecting cases on the propriety of taking such notice in cases involving "substantial media coverage" and "widespread publicity via newspaper and television news").

Grubman, and that Spitzer's office had issued a subpoena to Salomon asking for documents and e-mails relating to Grubman. See Charles Gasparino, As Lawyers Target Analysts, Now It's Grubman's Turn, Wall St. J., Apr. 12, 2002, available at www.wsj.com. On April 25, 2002, Attorney General Spitzer formally announced that he was investigating Grubman and Salomon for failure to disclose conflicts of interest and, on April 26, 2002, the SEC announced that it had opened a "formal inquiry" into the same subject. See Gretchen Morgenson, Wall Street Inquiry Expanded, With Subpoena to Salomon, N.Y. Times, Apr. 25, 2002, available at www.nytimes.com; Charles Gasparino & Scot J. Paltrow, SEC Joins Pack, Opens Inquiry Into Analysts, Wall St. J., Apr. 26, 2002, available at www.wsj.com. All of these disclosures predated WorldCom's bankruptcy, and the price of WorldCom stock fell dramatically in response, falling over 80% -- from $10 in mid-February 2002 to less than $2 in early June.

Salomon and Grubman argue that the Complaint must plead "that the subsequent disclosure of the omitted facts ultimately caused the price to drop below what plaintiffs paid." Salomon Br. at 25. This too is incorrect. "[T]he plaintiff is not required to prove that the defendant's act was the sole and exclusive cause of his injury; he need only show that it was 'substantial,' i.e., a significant contributing cause." Wilson v. Comtech Telecom. Corp., 648 F.2d 88, 92 (2d Cir. 1981) (internal quotations omitted).[50] This Court's decision in Kernaghan is on point. In that case, the former CEO of Global Intellicom moved to dismiss the complaint alleging, inter alia, that the complaint did not adequately

[50] Numerous courts have held that it is unnecessary to allege that a defendant's misrepresentations and omissions were the sole reason that the plaintiff's investment declined in value. See, e.g., Caremark, Inc. v. Coram Healthcare Corp., 113 F.3d 645, 649 (7th Cir. 1997) (plaintiff adequately pled loss causation because, although complaint alleged that other causes could have contributed to fall in value of securities,"it is possible for more than one cause to affect the price of a security and, should the case survive to that point, a trier of fact can determine the damages attributable to the fraudulent conduct."); Bruschi v. Brown, 876 F.2d 1526, 1531 (11th Cir. 1989) (same).

allege loss causation. 2000 WL 640653, at *9. The complaint alleged that the plaintiffs suffered damage after relying on the defendants' misrepresentations as to the company's financial condition and the defendants' intent to honor certain agreements that restricted plaintiffs' rights to convert their preferred shares. Based on these allegations, the Court found that the defendant's actions were a "substantial factor in the sequence of responsible causation" and a "foreseeable consequence of the misrepresentations given the context in which they were made." Id. at *10. In denying the motion to dismiss, this Court held that "[b]ecause on the facts alleged by plaintiffs, there is a reasonable probability that the fraud actually accomplished the result it was intended to bring about . . . plaintiffs have adequately pleaded loss causation." Id.

The analyst reports clearly contributed to the inflation of the price of WorldCom's stock and the disclosure of the conflicts contributed to enormous decline in the price of WorldCom securities that occurred in 2002. This is all that is required to demonstrate loss causation.

POINT III

THE COMPLAINT STATES CLAIMS UNDER SECTION 15(a) OF THE SECURITIES ACT AND SECTION 20(a) OF THE EXCHANGE ACT

The Complaint names Ebbers, Sullivan, Myers, Yates and the Director Defendants as having violated Section 15 of the Securities Act with respect to the 2000 and 2001 Offerings (Count II) and Section 20(a) of the Exchange Act (Count VII). The Complaint also asserts a claim against Citigroup and Salomon for violating Section 20(a) of the Exchange Act (Count XI).[51]

To establish controlling person liability under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), a plaintiff must:

> allege a primary violation by the controlled person and control of the primary violator by the targeted defendant, and show that the controlling person was in some meaningful sense a culpable participant in the fraud perpetrated by the controlled person. Control over a primary violator may be established by showing that the defendant possessed the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract or otherwise.

In re Oxford Health Plans, Inc., 187 F.R.D. 133, 142 (S.D.N.Y. 1999) (citing SEC v. First Jersey Securities, Inc., 101 F.3d 1450, 1472 (2d Cir. 1996)); see also Boguslavski v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998).[52]

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[51] Count XI asserts control person liability against Citigroup as a control person of Salomon and against Salomon as a control person of Grubman. As set forth above, neither Citigroup nor Salomon argues that it was not a control person. Rather, they disclaim liability on the basis that there is no underlying liability under Section 10(b). As set forth in Point II.D., this argument is without merit.

[52] Section 15 of the Securities Act has a similar provision and is interpreted in a similar manner. As the court summarized in In re: APAC Teleservices, Inc. Sec. Litig., No. 97 Civ. 9145, 1999 WL 1052004, at *11 (S.D.N.Y. Nov. 19, 1999) (quotations and citations omitted):

> Section 15 of the [Securities] Act and § 20(a) of the [Exchange] Act provide liability for every person who "controls any person liable" under §§ 11 and 12(a)(2) of the [Securities] Act or § 10(b) of the [Exchange] Act. The prevailing standard for establishing a prima facie showing of control person liability is met by pleading that the

In Jacobs v. Coopers & Lybrand, L.L.P., No. 97 Civ. 3374, 1999 WL 101772 (S.D.N.Y. 1999), plaintiffs alleged that the individual defendant was properly considered a controlling person "because he signed the company's 1995 10-K form, which contained material misrepresentations." The court noted a split in this Circuit with respect to outside directors, in that while some courts within the Circuit "have concluded that such an allegation is insufficient to allege § 20(a) control person status," other courts "have reached the opposite conclusion, ruling that allegations that an outside director signed a fraudulent report and was in the position to exercise control over the primary violation are sufficient to withstand a motion to dismiss."

The court in Jacobs held that the rationale of the second line of cases holding an outside director liable as a controlling person was more compelling: "It does comport with common sense to presume that a person who signs his name to a report has some measure of control over those who write the report." Id. at *18 (emphasis added). As a result, the court in Jacobs concluded that a plaintiff "need only to allege that the defendant had control; the defendant may argue good faith and lack of participation as an affirmative defense in a later state of the proceedings." Id.; accord In re Leslie Fay Cos., Inc. Sec. Litig., 918 F. Supp. 749 (S.D.N.Y. 1996) (where plaintiffs alleged that outside directors, among others, each signed at least one of the allegedly fraudulent documents, that supported inference that the directors exercised degree of control over company's operations and representations, and plaintiffs' allegations were sufficient at pleading stage for Section 20(a) claim); Robbins v. Moore Med. Corp., 788 F. Supp. 179, 189 (S.D.N.Y. 1992) (where each defendant, including outside directors, had signed at least one of the allegedly fraudulent documents, which

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individuals each controlled a primary violator of the securities.

supported plaintiffs' argument that they exercised control over company's operations, that was sufficient to sustain a Section 20(a) claim at the pleading stage); see also JWP, 928 F. Supp. 1239, 1260 (S.D.N.Y. 1996) (denying summary judgment motion of outside directors who served on audit committee of public company on ground that audit committee members were responsible, among others, for keeping JWP on the "straight and narrow" and that the audit committee "had the practical ability to direct JWP's accounting policies").

Indeed, this Court has affirmatively expressed its concurrence with the Jacobs ruling. In Kernaghan, while the Court acknowledged that officer or director status alone does not constitute control, it further stated its agreement "with those [courts] finding that the signing of a fraudulent SEC filing raises a sufficient inference of control." 2000 WL 640653, at *7 (citing In re Livent Inc. Sec. Litig., 78 F. Supp. 2d 194, 221-22 (S.D.N.Y. 1999) and Jacobs v. Coopers & Lybrand, L.L.P., 1999 WL 101772, at *17).[53]

As discussed above, none of the Defendants disputes that WorldCom's financial statements, Forms 10-Ks and 10-Qs, and press releases, as well as the registration statements and prospectuses

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[53] Defendants argue that the Court's subsequent opinion in In re Sotheby's Holdings, Inc. Sec. Litig., 2000 WL 1234601 (S.D.N.Y. Aug. 31, 2000), is inconsistent with Global Intellicom on this point. However, the decision in Sotheby's turned on the lack of any valid allegations connecting certain financial officer defendants to the underlying fraudulent scheme -- a price-fixing scheme that the company's two most senior executives allegedly entered into with Christies. Unlike in the present case, the complaint there did not allege that any of the financial officer defendants possessed any specific knowledge of the alleged illegal conduct, did not allege the existence of any specific documents or other information contradicting the public statements that were available to these defendants, and did not allege facts demonstrating that these defendants failed to review or check information that they had a duty to monitor or that they ignored obvious signs of fraud. Id. at *7 (citing Novak v. Kasaks, 216 F.3d 300, 308 (2nd Cir. 2000). The plaintiffs in Sotheby's, thus, were unable to plead adequately any control of these defendants "over the wrongdoer and the transactions in question," thereby requiring the dismissal of the control person claims against the financial officer defendants.

issued in connection with the Offerings, were materially false and misleading. Rather, they deny that they are legally responsible as control persons for these statements. However, the Complaint here satisfies the test for pleading control person liability against Ebbers and each of the WorldCom Director Defendants with respect to the Section 15 claim in Count II and the Section 20(a) claim in Count VII.

The case against Ebbers is crystal clear. As the CEO of WorldCom, he was in a position to control the Company's statements, as well as the direct superior of its other senior management executives -- including Sullivan, Myers and Yates, the persons who implemented the fraud. Ebbers held the highest management position at WorldCom, was involved in the day-to-day operations of the Company, was aware of the serious operational and financial problems of the Company (which directly contradicted statements that Ebbers and others issued on behalf of WorldCom), and directed the acquisition program at WorldCom that required it to maintain an inflated stock price. Indeed, Ebbers made explicit statements vouching not only for WorldCom's reported results (see generally ¶¶ 112-90), but also for the Company's accounting practices -- going so far as to assert its full compliance with all SEC rules. ¶¶ 180, 184. In these circumstances, Ebbers' control person liability has been more than sufficiently alleged. See Oxford Health, 187 F.R.D. at 453; First Jersey Securities, 101 F.3d at 1472; Global Intellicom, 2000 WL 640653, at *7 (finding allegations sufficient with respect to defendants Mortman and Keizer); In re Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d 314, 331-33 (S.D.N.Y. 2001) (finding control person liability adequately alleged against founder of company notwithstanding that he did not serve as officer or director of company).

The Complaint similarly adequately alleges control person liability for the Director Defendants. Each of these individuals signed at least certain of WorldCom's fraudulent SEC filings. Further, each of the directors knew, or certainly should have known, that the capital expenditure figures reported on the

Company's books greatly exceeded the capital expenditures approved by the Board. See Point II.B. While the knowledge and access to information that they had a duty to monitor is clearest with respect to the members of the Audit Committee (that is, Allen, Areen, Bobbitt and Galesi), the fact is that the entire Board had an obligation to oversee the Company's capital expenditures which, as WorldCom's admissions now show, were overstated by more than $3 billion during 2001 alone, and by another $800 million in the first quarter of 2002. ¶ 100. Given these facts, the Complaint has adequately alleged control person liability on the part of each of the WorldCom Director Defendants. See Leslie Fay, 918 F. Supp. at 763-64 (service as directors, and review and signing of SEC filings containing fraudulent financial information sufficient to satisfy control person standard); Robbins v. Moore Medical, 788 F. Supp. at 188-89 (identification of defendants as officers or directors, that they signed or otherwise issued statements of company, and averments of knowing or reckless participation in alleged scheme sufficient to plead control person liability); Lernout & Hauspie, 286 B.R. at 40 (holding that audit committee members "possessed and exercised control over L&H with respect to the financial reports and SEC filings" based on signatures by the members on L&H's SEC filings and their access to L&H's financial information).

The Director Defendants' reliance on Kimmel v. Labenski, No. 85 Civ. 0804, 1988 WL 19229 (S.D.N.Y. Feb. 10, 1988), is as unavailing here as it was in Leslie Fay. In Kimmel, the court found that the plaintiffs' allegations that individual defendants who served on the corporation's audit committee, reviewed the company's financials with an outside consultant and signed SEC filings were insufficient for Section 20(a) purposes. Id. at *6. However, the court specifically noted that the plaintiffs' allegations did not sufficiently explain how the company's SEC filing at issue, a Form 10-K, contained material misrepresentations or omissions. See id. at *2. Thus, Kimmel merely stands for the

settled principle of law that director or officer status alone is insufficient to state a Section 20(a) control claim unless other elements of the claim are satisfied.

Here, as shown above, the Complaint alleges far more than the Director Defendants' mere status. Contrary to the bare-bones claims in Kimmel, plaintiffs here have: (1) alleged that there were SEC filings which contained material misrepresentations and/or omissions; (2) explained how WorldCom's SEC filings contained material misrepresentations and/or omissions; (3) alleged that the WorldCom Directors (especially those who were members of the Audit Committee) had a duty to review the challenged information and failed to fulfill that duty; and (4) alleged that the WorldCom Directors either knew or should have known that the information contained in the SEC filings were fraudulent and/or misleading. Thus, the allegations that these Defendants signed fraudulent SEC filings which they either knew or should have known were false are sufficient to state a claim for controlling person liability.

CONCLUSION

For the foregoing reasons, all of the motions to dismiss should be denied.[54]

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[54] As the Court is aware, the myriad investigations into WorldCom are continuing. Accordingly, if the Court determines that any Counts are not sufficiently pled, Lead Plaintiff respectfully requests leave to amend. See Fed. R. Civ. P. 15(a); Foman v. Davis, 371 U.S. 178 (1962).

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