UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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IN RE WORLDCOM, INC. SECURITIES LITIGATION :	MASTER FILE 02 Civ. 3288 (DLC)
This Document Relates to: :	<u>OPINION AND ORDER</u>
ALL ACTIONS :	

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Appearances:

For Lead Plaintiff in the <u>Securities Litigation</u>:
Max W. Berger
John P. Coffey
Steven B. Singer
Beata Gocyk-Farber
John C. Browne
Jennifer L. Edlind
Bernstein Litowitz Berger & Grossman LLP
1285 Avenue of the Americas
New York, NY 10019-6028

Leonard Barrack
Gerald J. Rodos
Jeffrey W. Golan
Mark R. Rosen
Jeffrey A. Barrack
Pearlette V. Toussant
Barrack Rodos Bacine
3300 Two Commerce Square
2001 Market St.
Philadelphia, PA 19103

For Defendant Bernard J. Ebbers:
David Wertheimer
Lyndon Tretter
Hogan & Hartson
875 Third Ave.
New York, NY 10022

For Director Defendants:
Paul Curnin
Simpson Thacher & Bartlett LLP
425 Lexington Ave.
New York, NY 10017-3954

For Underwriter Defendants:
Jay B. Kasner
Susan L. Saltzstein
Steven J. Kolleeny
Skadden Arps Slate Meagher & Flom LLP
Four Times Square
New York, NY 10036-6522

For Defendants Citigroup Global
Markets, Inc. f/k/a Salomon Smith
Barney, Inc., Citigroup Inc.,
and Jack Grubman:
Martin London
Richard A. Rosen
Brad S. Karp
Eric S. Goldstein
Walter Rieman
Marc Falcone
Joyce S. Huang
Paul Weiss Rifkind Wharton
& Garrison LLP
1285 Avenue of the Americas
New York, NY 10019

Robert McCaw
Peter K. Vigeland
Wilmer Cutler & Pickering
399 Park Ave.
New York, NY 10022

DENISE COTE, District Judge:

On June 25, 2002, telecommunications giant WorldCom, Inc.("WorldCom")[1] issued the first of several announcements that its certified financial results had to be restated. By late July 2002, WorldCom had filed the largest bankruptcy in United States history. Extensive litigation arising from the financial scandal at WorldCom has been filed in state and federal courts across the country by investors large and small who purchased WorldCom debt and equity securities, and who allege individual as well as class

[1] WorldCom now does business as MCI, Inc.

claims. Although the litigation, like the scandal, is mammoth, the securities law claims are not unusual. Plaintiffs contend that WorldCom and those associated with it disseminated materially false and misleading information that affected the price of WorldCom securities and misled investors regarding the true value of the company.

On April 30, 2002, the first securities class action in connection with the WorldCom events was filed in the Southern District of New York. Subsequent litigation arising from the collapse of WorldCom was assigned to this Court by the Judicial Panel on Multi-District Litigation ("MDL Panel") and transferred here for pre-trial coordination or consolidation. By Order dated August 15, 2002, the securities class actions before this Court were consolidated as the In re WorldCom, Inc. Securities Litigation ("Securities Litigation"), the New York State Common Retirement Fund ("NYSCRF") was appointed Lead Plaintiff, and its counsel were appointed co-Lead Counsel for the consolidated class. This Opinion addresses Lead Plaintiff's motion for certification of the class.

Two sets of defendants have filed briefs in opposition to the motion for certification. Those briefs principally address whether the named plaintiffs added by NYSCRF to pursue claims based on purchases of WorldCom's bonds are adequate class representatives; whether issues common to the class will predominate over issues concerning each individual investor, specifically, whether a presumption of reliance should apply to the claim brought under Section 11 of the Securities Act of 1933

("Securities Act") on behalf of bondholders who purchased bonds more than twelve months after they were issued; and whether a presumption of reliance should apply to the claims brought under Section 10(b) of the Exchange Act of 1934 ("Exchange Act") against WorldCom's lead underwriter and its chief outside analyst.

I. Background

On October 11, 2002, NYSCRF filed a Consolidated Amended Complaint ("Complaint") adding three named plaintiffs who join NYSCRF in alleging claims on their own behalf and on behalf of those who acquired publicly traded WorldCom securities. Plaintiffs allege claims arising under the Securities Act and the Exchange Act against WorldCom officers, directors, auditors, underwriting syndicates, and its most influential outside analyst and his investment bank. By Opinion and Order dated May 19, 2003 ("May 19 Opinion"), the defendants' motions to dismiss the claims against them were largely denied.[2] See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 21219049 (S.D.N.Y. May

[2] The Exchange Act Section 10(b) claims against four WorldCom directors who were members of the Audit Committee ("Audit Committee Defendants") were dismissed with leave to amend. The Audit Committee Defendants were also named as defendants in the Section 20(a) Exchange Act claim and the Sections 11 and 15 Securities Act claims. They did not move against the Section 11 claim, and their motion to dismiss the Sections 20(a) and 15 claims was denied. The motions by WorldCom's auditors and accountants were addressed in an Opinion and Order dated June 24, 2003. Arthur Andersen LLP's motion to dismiss was denied; the motions to dismiss filed by Arthur Andersen (United Kingdom), Andersen Worldwide SC, and Andersen partners Mark Schoppet and Melvin Dick were granted. See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 21488087 (S.D.N.Y. June 24, 2003).

19, 2003). On August 1, 2003, plaintiffs filed the First Amended Class Action Complaint ("Amended Complaint"). The descriptions below summarize allegations in the Amended Complaint relevant to the class certification motion as well as, where indicated, additional information about the investments in WorldCom securities made by the named plaintiffs.

The Proposed Class

NYSCRF, together with the three additional named plaintiffs, seeks certification pursuant to Rules 23(a) and (b)(3), Fed. R. Civ. P., of a plaintiff class consisting of all persons and entities who purchased or otherwise acquired publicly traded securities of WorldCom during the period beginning April 29, 1999 through and including June 25, 2002 ("Class Period"), and who were injured thereby. This includes all persons or entities who acquired shares of WorldCom common stock in the secondary market or in exchange for shares of acquired companies pursuant to a registration statement, and all persons or entities who acquired debt securities of WorldCom in the secondary market or pursuant to a registration statement (the "Class").[3] The Amended Complaint includes detailed allegations and several causes of action addressed to registration statements for two massive bond offerings in the amount of $5 billion of Notes on May 24, 2000

[3] The Class excludes the defendants; members of the families of the individual defendants; any entity in which any defendant has a controlling interest; officers and directors of WorldCom and its subsidiaries and affiliates; and the legal representatives, heirs, successors or assigns of any such excluded party.

("2000 Offering" and “2000 Notes”) and $11.8 billion of Notes on May 15, 2001 ("2001 Offering" and “2001 Notes”).

The Proposed Class Representatives

Lead Plaintiff NYSCRF is the second largest public pension fund in the United States. NYSCRF invests and holds the assets of the New York State and Local Employees' Retirement System and the New York State and Local Police and Fire Retirement System. During the class period, NYSCRF purchased WorldCom stock, WorldCom MCI tracking stock, and WorldCom debt securities,[4] and lost over $300 million from those investments. The NYSCRF does not contend that it purchased Notes from either the 2000 or 2001 Offering.

The Fresno County Employees Retirement Association ("FCERA") is a California entity that invests funds for the purpose of providing retirement compensation and death and disability benefits for Fresno County employees and their beneficiaries. During the Class Period, FCERA is alleged to have purchased WorldCom stock and WorldCom debt securities, including $3.5 million of Notes in the 2001 Offering. FCERA lost over $11 million as a result of its investments in WorldCom securities. The evidence submitted with this motion shows that FCERA purchased the 2001 Notes in the initial offering.

The County of Fresno, California ("Fresno") invests the general funds of the County of Fresno. During the Class Period, Fresno purchased over $6.3 million of Notes from the 2000

[4] NYSCRF purchased over $1 million worth of WorldCom debt securities from 1998 bond offerings.

Offering. Fresno lost over $5.5 million as a result of this investment. The evidence submitted in connection with this motion indicates that the Notes were purchased in December 2001, and not in the initial offering.

HGK Asset Management, Inc. ("HGK") is a registered investment advisor and acts as a fiduciary to its union-sponsored pension and benefit plan clients under the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 et seq. HGK purchased WorldCom stock and over $130 million of WorldCom debt securities, including purchases in both the 2000 and 2001 Offerings. As a result of its investments in WorldCom, HGK lost close to $29 million.

The Defendants

The defendants consist of WorldCom directors;[5] executives,[6] including former President and Chief Executive Officer Bernard J. Ebbers ("Ebbers");[7] WorldCom's outside auditor and accountant, Arthur Andersen LLP ("Andersen"); the underwriters for the 2000 and 2001 Offerings;[8] the high-profile telecommunications analyst

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[5] Clifford Alexander, Jr., James C. Allen, Judith Areen, Carl J. Aycock, Max E. Bobbitt, Francesco Galesi, Stiles A. Kellett, Jr., Gordon S. Macklin, John A. Porter, Bert C. Roberts, Jr., John W. Sidgmore, and Lawrence C. Tucker ("Director Defendants").

[6] Scott D. Sullivan, David F. Myers, and Buford Yates, Jr. Litigation against Sullivan and Myers was stayed by Order dated December 5, 2002, and against Yates by stipulation and Order dated May 6, 2003.

[7] Ebbers resigned from WorldCom under pressure on April 29, 2002.

[8] The underwriters consist of Salomon Smith Barney, Inc., J.P. Morgan Chase & Co. ("J.P. Morgan"), Banc of America

Jack Grubman ("Grubman"), his employer, the financial services firm Salomon Smith Barney, Inc. ("SSB"),[9] and SSB's corporate parent, Citigroup, Inc. ("Citigroup"). SSB was the co-lead underwriter with J.P. Morgan for the 2000 and 2001 Offerings. SSB was the book running manager for the 2000 Offering and the joint book runner for the 2001 Offering. Grubman, SSB and Citigroup are referred to herein as the "SSB Defendants."

A summary of allegations in the Amended Complaint relevant to this motion follows. Since the Underwriter Defendants and the SSB Defendants have submitted the only two substantive briefs in opposition to class certification, the allegations pertinent to them are described in more detail.[10]

The Accounting Fraud

Plaintiffs allege that WorldCom and those affiliated with it misled investors by engaging in a series of illegitimate accounting strategies that hid losses and inflated the company's

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Securities LLC, Deutsche Bank Securities Inc., now known as Deutsche Bank Alex. Brown Inc., Chase Securities Inc., Lehman Brothers Inc., Blaylock & Partners L.P., Credit Suisse First Boston Corp., Goldman, Sachs & Co., UBS Warburg LLC, ABN/AMNRO Inc., Utendahl Capital, Tokyo-Mitsubishi International plc, Westdeutsche Landesbank Girozentrale, BNP Paribas Securities Corp., Caboto Holding SIM S.p.A., Fleet Securities, Inc., and Mizuho International plc ("Underwriter Defendants").

[9] The Amended Complaint explains that Salomon Smith Barney, Inc. now does business as Citigroup Global Markets, Inc.

[10] The Director Defendants and Ebbers join in opposing class certification, but did not file separate briefs. Andersen did not file a brief or join in opposition to the motion. The alleged role of each of the defendants as pleaded in the Complaint is set forth in the May 19 Opinion on the motions to dismiss. See In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *2-10.

earnings. The allegations focus on WorldCom's manipulation of its accounting relating to two main areas: its numerous acquisitions and its "line costs."[11] Plaintiffs contend that investors were misled by false information regarding WorldCom's financial state that appeared in analyst reports, press releases, public statements, and filings with the Securities and Exchange Commission ("SEC") during the Class Period, including registration statements and prospectus statements issued in connection with the 2000 and 2001 Offerings.[12]

WorldCom has admitted that its financial statements were overstated by over $9 billion from 1999 through the first quarter of 2002. WorldCom improperly booked close to $1 billion in revenue during the Class Period. WorldCom has written off $80 billion of the stated book value of its assets recorded as of June 2002. WorldCom's disclosures in 2002 had a catastrophic effect on the price of its shares and the value of its notes.

<u>The Offerings</u>

The plaintiffs allege that Underwriter Defendants failed to conduct proper due diligence in connection with the 2000 and 2001

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[11] Line costs are the costs incurred by WorldCom's long-term lease agreements with various telecommunications carriers to allow WorldCom to use the carriers' networks to carry the calls of WorldCom's customers.

[12] In connection with the 2000 Offering, WorldCom filed SEC Form S-3 registration statements on April 12 and May 11, 2000 and Form 424(B)(5) prospectus supplements dated May 17, 19 and 22, 2000 (collectively "2000 Registration Statement"). In connection with the 2001 Offering, WorldCom filed a Form S-3 registration statement dated May 9, 2001 and a Form 424(B)(5) prospectus supplement dated May 11, 2001 (collectively "2001 Registration Statement," and together the "Registration Statements").

Offerings. Had they done so, they would have discovered the accounting fraud and the massive infirmities in WorldCom's financial position. The Underwriter Defendants failed to describe WorldCom's financial condition accurately and to examine and identify the risks an investment in WorldCom posed to investors. They did not include any risk disclosures in the Registration Statements, nor did they notify potential investors that WorldCom had no plans to monitor or satisfy its massive debt. The Registration Statements were also false and misleading because they failed to disclose critical information regarding the nature and extent of the illicit quid pro quo relationship that existed between the SSB Defendants and WorldCom.

The Quid Pro Quo Relationship

The plaintiffs allege that SSB and Grubman on the one hand, and WorldCom and Ebbers on the other, had a close and self-serving relationship from which both sides derived substantial benefit. WorldCom's securities prices were artificially inflated by Grubman's reports. He was SSB's star telecommunications analyst and consistently encouraged investors to buy WorldCom securities. An August 2002 Time magazine article reported that "every big investor knew Grubman was the 'ax', the one man who could make or break any stock in [the telecommunications] industry with a thumbs-up or thumbs-down."

SSB and Grubman were well remunerated for their support of WorldCom. Between October 1997 and February 2002, SSB received a significant portion of WorldCom's investment banking business, for which WorldCom paid approximately $107 million over the

course of twenty-three deals. Between 1998 and 2002, Grubman made about $20 million each year in compensation, tied in part to the value SSB derived from his involvement in its investment banking transactions.

In exchange for WorldCom's lucrative business, SSB provided Ebbers and other WorldCom senior executives with valuable IPO shares. SSB’s corporate sibling The Travelers Insurance Company ("Travelers") secretly loaned Ebbers hundreds of millions of dollars, which were secured at least in part by Ebbers’s WorldCom stockholdings. And, SSB published Grubman's relentlessly positive, but materially false, reports about WorldCom.

SSB and Grubman issued the analyst reports despite SSB's knowledge that the integrity and objectivity of its research department was compromised by the department's drive to serve the needs of the firm's investment banking division, despite Grubman's knowledge or reckless disregard of the substantial financial problems at WorldCom, and despite the material misstatements or omissions contained in the reports. Grubman even altered his valuation model in order to obscure WorldCom’s deteriorating finances. As SSB knew, Grubman's analysis was not the work of an objective researcher, but of someone functioning as a WorldCom insider. For example, Grubman attended at least two meetings of WorldCom’s Board of Directors, and advised WorldCom regarding a contemplated acquisition of Nextel. Grubman even helped Ebbers conceal WorldCom's financial problems from investors by scripting Ebbers's statements for certain earnings conference calls. Grubman then published analyst reports

containing similar assurances and relying in part on the scripted statements he had provided for Ebbers. In disseminating such misleading reports, Grubman and SSB helped to inflate artificially the price of WorldCom securities, and caused plaintiffs to suffer substantial losses.

Adequately disclosing the illicit relationship between WorldCom and SSB would have made it apparent to investors that Grubman's analyst reports were not reliable. In sum, the illicit arrangement between WorldCom and the SSB Defendants is among the allegations that are at the core of the Amended Complaint.[13]

The Aftermath

On June 26, 2002, the day after WorldCom's first restatement announcement, the SEC filed a civil complaint against the company. The U.S. House of Representatives Committees on Energy and Commerce and on Financial Services immediately initiated investigations. Beginning in July, the United States Attorney for the Southern District of New York filed criminal charges against various former officers of WorldCom.[14] WorldCom's former

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[13] The interconnections between the various counts, allegations, and defendants in this action have also been addressed in prior Opinions. See, e.g., In re WorldCom, Inc. Sec. Litig., 02 Civ. 3288 (DLC), 2003 WL 1563412, at *3 (S.D.N.Y. Mar. 25, 2003) (SSB Defendants' motion to sever); In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *28-35 (motion to dismiss).

[14] The criminal trial of the former WorldCom Chief Financial Officer is scheduled to begin in February 2004 before the Honorable Barbara S. Jones of this district. The facts relating to the criminal charges and their effect on this litigation are set forth more fully in prior Opinions. See In re WorldCom, Inc. Securities Litigation, 234 F. Supp. 2d 301 (S.D.N.Y. 2002); In re WorldCom, Inc. Securities Litigation No. 02 Civ. 3288 (DLC), 2002 WL 31729501, at *2-7 (S.D.N.Y. Dec. 5, 2002).

Controller and other WorldCom employees have pleaded guilty. WorldCom filed for Chapter 11 bankruptcy in the Bankruptcy Court of this district on July 21, 2002.

On November 26, 2002, WorldCom announced that it had reached a partial settlement with the SEC, and had agreed to the entry of a permanent injunction barring it from further violating the securities laws. WorldCom has consented to a penalty of $2.25 billion, which after the bankruptcy proceedings would result in a settlement payment of $750 million. The Honorable Jed S. Rakoff of this district approved the settlement on July 7, 2003.

SSB and Grubman have also been the subject of government and regulatory investigation. SSB was one of ten investment banks,[15] and Grubman one of two individual analysts who entered into a global settlement arising from the joint investigations conducted by the SEC, the New York State Attorney General's Office and others into the undue influence of investment banking on securities research. Citigroup agreed to pay $400 million in settlement, including $150 million in penalties and $150 million in disgorgement.

<u>The Claims</u>

The Amended Complaint alleges claims arising under the Securities Act (Counts I through V) and the Exchange Act (Counts VI through XI). The Securities Act claims arise from the 2000 and 2001 Offerings and Registration Statements. The plaintiffs

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[15] Five of the Underwriter Defendants were also among the ten banks that entered into the global settlement: they are J.P. Morgan, Credit Suisse First Boston Corp., Goldman, Sachs & Co., UBS Warburg LLC, and Lehman Brothers Inc.

plead Section 11 claims against Ebbers, Sullivan and the Director Defendants (Count I), Andersen (Count III), and the Underwriter Defendants (Count IV). Count V asserts Section 12(a)(2) claims against the Underwriter Defendants. Count II charges the Director and officer Defendants with violating Section 15 through their control over the contents of the 2000 and 2001 Registration Statements and their role as "controlling persons" of WorldCom.

The Exchange Act claims consist of securities fraud claims under Section 10(b) and controlling person claims under Section 20(a). Count VI alleges that Ebbers, Sullivan, Myers, Yates, and Director Defendants Bobbitt, Allen, Areen and Galesi ("Audit Committee Defendants") violated Section 10(b) in connection with materially false and misleading statements included in, _inter alia_, WorldCom filings with the SEC, press releases, and registration statements.[16] Count VIII alleges that Andersen violated Section 10(b) by disseminating material misrepresentations and by participating in a scheme to misrepresent WorldCom's financial condition, to consummate acquisitions and the 2000 and 2001 Offerings, and to inflate artificially or maintain WorldCom securities prices. Count IX asserts that SSB and Grubman violated Section 10(b) in connection with the material misstatements and omissions contained in the 2000 and 2001 Registration Statements and by conspiring with Ebbers and WorldCom to misrepresent WorldCom's financial

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[16] The Section 10(b) claim in the Complaint against the Audit Committee Defendants was dismissed in the May 19 Opinion. The Audit Committee Defendants' motion to dismiss the Section 10(b) claim in the Amended Complaint is not yet _sub judice_.

condition in connection with the 2000 and 2001 Offerings. Count X alleges that SSB and Grubman also violated Section 10(b) in connection with Grubman's analyst reports and his adoption of Ebbers's material misstatements. Finally, the Amended Complaint pleads Section 20(a) claims against Director and officer Defendants as controlling persons of WorldCom and its employees (Count VII), and Citigroup and SSB as controlling persons of Grubman, and Citigroup as a controlling person of SSB and its employees, managers and directors (Count XI).

II. Discussion

Certification of a class should be determined "as soon as practicable" after an action has been commenced, Fed. R. Civ. P. 23(c)(1), so that the defendants may "be told promptly the number of parties to whom [they] may ultimately be liable for money damages." Siskind v. The Sperry Retirement Prof., Unisys, 47 F.3d 498, 503 (2d Cir. 1995) (citation omitted). At class certification, the court determines whether the requirements of Rule 23 are met, not whether the claims are adequately pleaded or who will prevail on the merits. See Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 178 (1974). The plaintiffs bear the burden of satisfying Rule 23.[17] Amchem Prods., Inc. v. Windsor,

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[17] The defendants contend that this motion should be denied because the plaintiffs did not submit sufficient evidence to support their class certification motion. While the plaintiffs' motion was pro forma, the defendants have not identified any prejudice. They were permitted an opportunity to take two depositions of persons associated with each named plaintiff, or eight depositions in all, in addition to obtaining extensive documentary evidence from the named plaintiffs. The two sets of defendants who submitted substantive briefs in opposition to the motion were also given an opportunity to submit surreply briefs.

521 U.S. 591, 614 (1997); Caridad v. Metro North Commuter R.R., 191 F.3d 283, 291 (2d Cir. 1999). A court must conduct a "rigorous analysis" to determine that the Rule 23 requirements have been satisfied and a class should be certified, but a decision to certify a class is "not an occasion for examination of the merits of the case." In re Visa Check/MasterMoney Antitrust Litig., 280 F.3d 124, 135 (2d Cir. 2001) (citation omitted).

To qualify for certification, plaintiffs must prove that the proposed class action meets the four requirements of Rule 23(a). See In re VisaCheck/MasterMoney, 280 F.3d at 132. Rule 23(a) provides that class members may sue as class representatives only if

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

Rule 23(a), Fed. R. Civ. P.

Plaintiffs must also establish that the class action may proceed under one of the categories of Rule 23(b). In this case, plaintiffs seek certification of the class pursuant to Rule 23(b)(3). Under Rule 23(b)(3) a class may be certified if, in addition to the requirements of Rule 23(a),

> the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a

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Although this is a massive case, the issues it presents are far from novel. The motion for class certification was sufficient in the circumstances.

class action is superior to other available methods for the fair and efficient adjudication of the controversy.

Rule 23(b)(3), Fed. R. Civ. P.

The Rule 23(b)(3) predominance inquiry is more demanding than the commonality determination required by Rule 23(a). Moore v. PaineWebber, Inc., 306 F.3d 1247, 1252 (2d Cir. 2002). Rule 23(b)(3) is designed for actions that will "secure judgments binding all class members save those who affirmatively elect[] to be excluded," and where a class action will "achieve economies of time, effort, and expense, and promote uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results." Amchem Prods., 521 U.S. at 614-15 (citation omitted). The court must look closely at each of the Rule 23(b)(3) criteria. Id. at 615.

A. The Rule 23(a) Requirements

(1) Numerosity

To satisfy the numerosity requirement of Rule 23(a), plaintiffs must show that joinder is "impracticable," not that it is "impossible." Robidoux v. Celani, 987 F.2d 931, 935 (2d Cir. 1993). Numerosity is presumed when a class consists of forty or more members. See Consolidated Rail Corp. v. Town of Hyde Park, 47 F.3d 473, 483 (2d Cir. 1995); cf. 15 U.S.C. § 77p(f)(2) (under the Securities Act an action on behalf of fifty or more members seeking damages is a "covered class action").

The defendants do not dispute the numerosity of the putative Class. WorldCom issued billions of shares and billions of dollars of debt securities during the Class Period, and it is

uncontested that tens of thousands of investors are putative class members.

(2) Commonality

Rule 23(a) also requires that the action raise an issue of law or fact that is common to the class. Robinson v. Metro-North Commuter R.R. Co., 267 F.3d 147, 155 (2d Cir. 2001); Marisol A. v. Giuliani, 126 F.3d 372, 376 (2d Cir. 1997) (per curiam); In re Agent Orange Prod. Liab. Litig., 818 F.2d 145, 166-67 (2d Cir. 1987). The commonality and typicality requirements of Rule 23(a) tend to merge into one another, as both "serve as guideposts for determining whether . . . the named plaintiff's claim and the class claims are so inter-related that the interests of the class members will be fairly and adequately protected in their absence." Caridad, 191 F.3d at 291 (quoting General Tel. Co. v. Falcon, 457 U.S. 147, 157 n.13 (1982)).

Plaintiffs have identified numerous common questions of law and fact, including misrepresentations and omissions in WorldCom's SEC filings and press releases, and in SSB's analyst reports in connection with the alleged accounting fraud and illicit quid pro quo relationship. The nature and extent of the misrepresentations, of the accounting fraud and of the quid pro quo relationship pose common questions of fact, and the liability of the various defendants pose questions of law common to the class members. Defendants do not contest that common questions of law or fact are raised by the Amended Complaint.

(3) Typicality

The typicality requirement of Rule 23(a) is satisfied when "each class member's claim arises from the same course of events, and each class member makes similar legal arguments to prove the defendant's liability." Robinson, 267 F.3d at 155 (citation omitted); see also In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 291 (2d Cir. 1992). The factual background of each named plaintiff's claim need not be identical to that of all of the class members as long as "the disputed issue of law or fact occup[ies] essentially the same degree of centrality to the named plaintiff's claim as to that of other members of the proposed class." Caridad, 191 F.3d at 293 (citation omitted). "When it is alleged that the same unlawful conduct was directed at or affected both the named plaintiff and the class sought to be represented, the typicality requirement is usually met irrespective of minor variations in the fact patterns underlying individual claims." Robidoux, 987 F.2d at 936-37. For example, the possibility that proof of injury might require separate evaluations of the artificiality of a commodities price at the moments affecting each of the class members need not defeat class certification. See In re Sumitomo Copper Litig., 262 F.3d 134, 140-41 (2d Cir. 2001). Together, the typicality and commonality requirements help to ensure that "maintenance of a class action is economical and whether the named plaintiff's claims and the class claims are so interrelated that the interests of the class members will be fairly and adequately protected in their absence." Falcon, 457 U.S. at 157 n.13.

The course of conduct alleged by the plaintiffs includes a pervasive accounting fraud and the correspondingly pervasive failure of those charged with monitoring and evaluating WorldCom to review diligently the company's financial records and representations, and of those who spoke of WorldCom’s financial condition to do so honestly and accurately. The claims of the named plaintiffs arise from that course of conduct and are typical of the claims of the Class. The named plaintiffs include parties who allege losses arising from the purchase of both bonds and stock. Both stock and bond purchasers will necessarily seek to develop facts sufficient to prove the underlying accounting fraud at WorldCom and the dissemination of material misrepresentations regarding the company's value, and to show why the misrepresentations were made. Although the bond purchasers have a special incentive to defeat any defense that the Underwriter Defendants' due diligence was adequate and to show the existence of misrepresentations in the Registration Statements, purchasers of equity securities also base their claims on those documents and have brought fraud claims against SSB, the co-lead underwriter for the two Offerings. Moreover, the Registration Statements incorporated WorldCom’s SEC filings, and the misrepresentations of WorldCom’s financial condition in the Registration Statements are alleged to be a part of a course of conduct that concealed WorldCom’s true financial condition from all investors in WorldCom securities.

The Underwriter Defendants contend that the claims of NYSCRF, the sole lead plaintiff, are not typical of the class

since NYSCRF did not purchase any bonds from the 2000 or 2001 Offerings and therefore cannot assert the Sections 11 and 12 claims under the Securities Act. The addition of named plaintiffs who were bondholders ensures that the litigation will continue to focus on the claims raised by bondholders, and that there are representatives of the Class with claims typical of purchasers of both types of securities. In any event, as noted, NYSCRF's claims are based on misrepresentations in the Registration Statements and on the same core course of conduct at issue in the Sections 11 and 12 claims.

The Underwriter Defendants also contend that the typicality requirement is not satisfied because one of the purchasers of the 2000 Notes, Fresno, suffers from a unique defense. Class certification is inappropriate "where a putative class representative is subject to unique defenses which threaten to become the focus of the litigation." Baffa v. Donaldson, Lufkin & Jenrette Sec. Corp., 222 F.3d 52, 59 (2d Cir. 2000) (emphasis supplied) (citation omitted); see also Cromer Finance Ltd. v. Berger, 205 F.R.D. 113, 123 (S.D.N.Y. 2001) (DLC) ("When a defense that is unique to a class representative threatens to dominate or even interfere with that plaintiff's ability to press the claims common to the class, then that threat must be analyzed with care.").

Specifically, the Underwriter Defendants contend that because Fresno purchased its 2000 Notes in December 2001, after WorldCom had issued financial statements covering at least twelve months following the 2000 Registration Statement, it must prove

that it relied on the 2000 Registration Statement to prevail on a Section 11 claim under the Securities Act and will be unable to do so. As described below, Fresno will not have to show reliance since there was no intervening financial statement that cured the misrepresentations in the 2000 Registration Statements, and it would in any event be entitled to a presumption of reliance. There is, therefore, no realistic danger that the issue of Fresno's reliance on the 2000 Registration Statement will dominate the litigation or interfere with its ability to represent the Class.[18]

The SSB Defendants contend that the claims of all of the named plaintiffs are atypical and subject to unique defenses because they did not rely, and cannot be presumed to have relied, on the market price for WorldCom securities. The SSB Defendants argue that one or more of the named plaintiffs relied on the advice of highly sophisticated investment managers, relied on the assessment that the market price was not accurate but in fact <u>understated</u> WorldCom's value, relied on their own conversations with WorldCom management, relied on computer models that replicate the portfolio of the S&P 500 Index, or relied on factors such as yield and S&P bond ratings.[19]

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[18] There is substantial evidence that the financial information from the 2000 Registration Statement was uncorrected at the time Fresno purchased its bonds, that it affected WorldCom's bond rating and other market indicators of investment quality, and that Fresno therefore relied, even if only indirectly, on the 2000 Registration Statement when it made its investment decision.

[19] With respect to NYSCRF alone, the SSB Defendants argue both that it invested passively without any analysis of WorldCom

This argument can be swiftly rejected. Each of these methods of making investment decisions is representative of methods used by many other investors. Each of the methods reflects an evaluation of the publicly available information about WorldCom, whether by the named plaintiff, the advisor, or a computer model. There is no suggestion that any of the named plaintiffs had access to non-public information and learned that there was a fraud afoot and decided nonetheless to invest in WorldCom. None of the different strategies that these institutional plaintiffs, each of whom is a fiduciary, used to make investment decisions on behalf of their beneficiaries suggests that these plaintiffs will be vulnerable at trial to a unique defense that will defeat the presumption that they relied on the public statements about WorldCom that are at issue here, or that will threaten to become the focus of the litigation.

The Private Securities Litigation Reform Act of 1995 ("PSLRA") directs a court to choose the "most adequate plaintiff" to represent the class. The PSLRA creates a presumption that the plaintiff with the largest financial interest and who otherwise satisfies the requirements of Rule 23, Fed. R. Civ. P., should serve as the lead plaintiff. 15 U.S.C. § 77z-1(a)(3)(B)(iii)(I). The PSLRA was designed to "increase the likelihood that institutional investors will serve as lead plaintiffs." S. Rep. No. 104-98, at 11 (1995); see also HR Conf. Rep. No 104-369, at 6 (1995). Such investors are likely to use advisors, to invest

when it used a computer model, and at the same time that it had too much knowledge about WorldCom through its advisors and its own conversations with WorldCom.

conservatively in securities they consider undervalued by the market, and on occasion even to communicate directly with the company in which they are investing to verify or better evaluate its public disclosures. Making careful investment decisions does not disqualify an investor from representing a class of defrauded investors or from relying on the presumption of reliance that is ordinarily available, as discussed in some detail below, in securities fraud actions. See, e.g., In re Independent Energy Holdings PLC Sec. Litig., 210 F.R.D. 476, 481-82 (S.D.N.Y. 2002) (test is whether named plaintiff received non-public information from a corporate officer); Cromer, 205 F.R.D. at 132 (use of investment advisors not disqualifying); Dietrich v. Bauer, 192 F.R.D. 119, 125 (S.D.N.Y. 2000) (direct receipt of public information from corporate defendant not disqualifying); Cross v. Dickstein Partners, 172 F.R.D. 108, 114 (S.D.N.Y. 1997) (reliance on brokers not disqualifying).[20]

(4) Adequacy of Representation

To determine whether a named plaintiff will be an adequate class representative, courts inquire whether: "1) plaintiff's interests are antagonistic to the interest of other members of the class and 2) plaintiff's attorneys are qualified, experienced and able to conduct the litigation." Baffa, 222 F.3d at 60; see

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[20] The cases on which the SSB Defendants rely are not to the contrary. For example, in Zlotnick v. Tie Communications, 836 F.2d 818, 823 (3d Cir. 1988), the Third Circuit refused to allow a short seller to use a presumption of reliance on the market price. In McGuinness v. Parnes, 1988 WL 66214, at *2-4 (D.D.C. 1988), the named plaintiffs suffered from "formidable, relatively unique" non-reliance defenses such as access to inside information.

also Falcon, 457 U.S. at 157 n.13; In re Visa Check/MasterMoney, 280 F.3d at 142; In re Drexel Burnham, 960 F.2d at 291. A class representative must "possess the same interest and suffer the same injury as the class members." Amchem Prods., 521 U.S. at 625-26 (citation omitted).

Here, both Baffa criteria are satisfied. The named plaintiffs' interests are directly aligned with those of the absent class members: they are purchasers of WorldCom equity and debt securities who suffered significant losses as a result of the investments. Their attorneys are all qualified, experienced and able to conduct complex securities litigation. Co-Lead Counsel in particular have already ably and zealously represented the interests of the Class as this complex litigation continues apace.

The defendants do not directly contest the proposed class representatives' qualifications under either of the two criteria identified by the Second Circuit as key to the adequacy determination. See Baffa, 222 F.3d at 60. The defendants do not identify any genuine antagonism between the named plaintiffs' interests and those of the Class, nor do they suggest that the plaintiffs' attorneys are not sufficiently qualified and experienced to conduct the litigation. Instead, the Underwriter Defendants raise four peripheral arguments regarding the named plaintiffs' adequacy:[21] (1) Fresno and FCERA's standing; (2)

[21] The defendants make many arguments regarding named plaintiff HGK. Because there is no doubt about the adequacy of Fresno and FCERA to represent the class, and because together they purchased bonds from both the 2000 and 2001 Offerings, it is unnecessary to add to the length of this Opinion by addressing

plaintiffs' lack of obligation to repay litigation costs; (3) Fresno and FCERA's role as "named" rather than "lead" plaintiffs; and (4) Fresno and FCERA's discharge of their duties to class members. None of these arguments succeeds in disqualifying either Fresno or FCERA as class representatives.

(a) Standing

Defendants contend that Fresno and FCERA are not adequate class representatives since they lack standing to bring the Securities Act Section 12(a)(2) claim because they were not in privity with any Underwriter Defendant when they purchased their Notes.[22] Underwriters in a firm commitment underwriting become the owners of any unsold shares, and may be liable as sellers for direct sales to the public. See Jackson Nat'l Life Ins. v. Merrill Lynch & Co., 32 F.3d 697, 701 (2d Cir. 1994); In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *13; In re American Bank Note Holographics, Inc. Sec. Litig., 93 F. Supp. 2d 424, 438-39 (S.D.N.Y. 2000).

Since FCERA purchased its bonds during the 2001 Offering, FCERA would have standing to bring a Section 12(a)(2) claim against any underwriter from whom it bought Notes or who successfully solicited the purchase. While no evidence was presented in connection with this motion to indicate precisely

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the arguments concerning HGK.

[22] The defendants also argue that neither Fresno nor FCERA has standing to sue every Underwriter Defendant named in the Section 11 claim, since each of them only has standing to sue those defendants who participated in the offering of the Notes that it purchased. Together, they do have such standing. No more is required.

from whom FCERA purchased its Notes or which, if any, of the Underwriter Defendants successfully solicited the sale, there is no dispute that FCERA bought bonds in the Offering.[23] Since Fresno purchased in the aftermarket it clearly does not have standing to bring a Section 12(a)(2) claim. Nonetheless, both Fresno and FCERA are adequate class representatives, including for those members of the Class who purchased in either the 2000 or 2001 Offerings.

The Section 12(a)(2) claim arises from the same course of conduct and the same Offerings, and involves the same defendants, legal theories and factual allegations that give rise to and inform the Section 11 claims. Those similarities are sufficient to satisfy the Rule 23(a) requirements, whether characterized as concerns about the adequacy of representation or the typicality of the claims. See, e.g., Hicks v. Morgan Stanley & Co., No. 01 Civ. 1007 (HB), 2003 WL 21672085, at *5 (S.D.N.Y. Jul. 16, 2003) (discussing Gratz v. Bollinger, __ U.S. __, 123 S.Ct. 2411, 2423 (2003)); In re Dreyfus Aggressive Growth Mutual Fund Litig., No. 98 Civ. 4318 (HB), 2000 WL 1357509, at *3-5 (S.D.N.Y. Sept. 20, 2000); In re Blech Sec. Litig., 187 F.R.D. 97, 105-06 (S.D.N.Y. 1999); Maywalt v. Parkey & Parsley Petroleum Co., 147 F.R.D. 51, 56-57 (S.D.N.Y. 1993). Even NYSCRF -- although it did not purchase in either Offering -- has claims based on the same Registration Statements and will have an incentive to pursue and

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[23] The Underwriter Defendants contend that FCERA lacks standing because the purchase was handled by FCERA's investment managers, but do not address whether title to 2001 Notes passed to FCERA and not its agent.

prove many of the facts that underlie the Sections 11 and 12(a)(2) claims.

(b) Litigation Costs

The Underwriter Defendants argue that the named plaintiffs are inadequate because they have not agreed to repay their pro rata share of the litigation costs to the law firms that are representing them. They rely on a provision of the New York Code of Professional Responsibility ("Code"), adopting Disciplinary Rule 5-103(b) of the Model Code ("DR 5-103"), which states that:

> A lawyer may advance or guarantee the expenses of litigation, including court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence, provided the client remains ultimately liable for such expenses.

NY. Comp. Codes R. & Regs. tit. 22, § 1200.22(b)(1) (West 2003)(emphasis supplied).[24] Plaintiffs contend that the PSLRA does not require the named or lead plaintiffs to bear the costs of litigation, and that DR 5-103 should not be applied to this securities class action.

In determining "[i]f a particular interpretation of a state ethics rule is inconsistent with or antithetical to federal interests, a federal court interpreting that rule must do so in a way that balances the varying federal interests at stake." Grievance Committee for the Southern District of New York v. Simels, 48 F.3d 640, 646 (2d Cir. 1995) (citation omitted) (emphasis in original). Here, strong federal interests require

[24] The Local Rules for the Southern District of New York provide that if "any attorney is found to have engaged in conduct violative of the New York State Lawyer's Code of Professional Responsibility" discipline or other relief may be imposed by the Committee on Grievances. See S.D.N.Y. Local Rule 1.5(b)(5).

that the repayment of expenses provision in DR 5-103 be disregarded. At the same time, the underlying goal of DR 5-103 -- that litigation be controlled by the client, not the attorney -- remains fully protected.

The New York rule arises from the ancient doctrine of maintenance, and the closely related doctrines of champerty and barratry. See Committee on Prof. Responsibility, Financial Arrangements in Class Actions and the Code of Professional Responsibility, 20 Fordham Urb. L.J. 831, 844 (1993); see also Boccardo v. C.I.R., 56 F.3d 1016, 1019 (9th Cir. 1995); Rand v. Monsanto Co., 926 F.2d 596, 600 (7th Cir. 1991). "Put simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty." Elliott Assoc. L.P v. Banco de la Nacion, 194 F.3d 363, 372 (2d Cir. 1999) (citation omitted). These doctrines reflect longstanding disapprobation of lawyer-driven litigation. DR 5-103, like the doctrines from which it derives, is informed by the fear that if attorneys obtain a financial stake in a lawsuit, they will be pursuing litigation in their own interests, not the interests of their clients. See Geoffrey P. Miller, Payment of Expenses in Securities Class Actions: Ethical Dilemmas, Class Counsel, and Congressional Intent, 22 Rev. Litig. 557, 561 (2003).

Like DR 5-103 and its underlying doctrines, the PSLRA ensures that control of the litigation remains in the hands of the clients, not their lawyers. See S. Rep. No. 104-98, at 6

(appointment of lead plaintiff procedures are "intended to empower investors so that they, not their lawyers, control securities litigation."). In fact, one of the concerns the PSLRA addressed was the use of "professional plaintiffs," who owned stock in numerous companies, were willing to be named in multiple class action complaints, and had long-standing relationships with particular firms, but exercised little or no control over the litigation or the attorneys. See id. at 9-10. Where DR 5-103 ensures client control by holding clients responsible for the expenses of litigation, the PSLRA ensures client control by encouraging the selection of a lead plaintiff who is an institutional investor with the largest financial stake in the action. See 15 U.S.C. § 77z-1(a)(3)(B)(ii). In addition to the PSLRA lead plaintiff provisions, Rule 23 requires judicial scrutiny of the adequacy of the class representatives. Consequently, requiring compliance with DR 5-103 is particularly unnecessary in the context of securities class actions since the PSLRA and Rule 23 together provide even greater assurance than the Code that the clients and not their attorneys control the litigation.

Moreover, requiring compliance with DR 5-103 and requiring named plaintiffs to pay litigation expenses, even their pro rata share of litigation expenses, can have deleterious effects on the federal class action device. Most states no longer follow this rule, and have instead adopted the ABA's Model Rules of Professional Conduct. See Chief Judge Edward R. Becker, Report:

Third Circuit Task Force on Selection of Class Counsel, 74 Temple L. Rev. 689, 691 n.7 (2001). ABA Model Rule 1.8(e)(1) provides:

> (e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation except that:
> (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter . . . .

Model Rules of Professional Conduct, Rule 1.8(e)(1) (1983) (emphasis supplied). This rule allows a lawyer to advance the costs of litigation subject to reimbursement only if the suit is successful. See Rand, 926 F.2d at 600.

As the Seventh Circuit held in Rand, DR 5-103 is "inconsistent with Rule 23." Id. at 600. It observed that in a class action, "the client is the class." Id. at 600. It further explained that as of 1990 a majority of states followed a rule permitting the attorney to bear the costs of litigation unless the litigation were successful, and that "following the different state rules on the allocation of costs would balkanize litigation," and encourage counsel to recruit class representative plaintiffs resident in a district with local rules more amenable to class actions. Id. The court concluded that DR 5-103 should "not be applied to class actions." Id.[25]

Although in Rand the named plaintiff had been disqualified because he was unwilling to bear all of the costs, id. at 601, the same reasoning applies where a named plaintiff has not agreed to bear even its pro rata share of the costs. Where the

[25] The Rand court also noted that local federal court rules are valid only to the extent they are consistent with the Federal Rules of Civil Procedure. See Rand, 926 F.2d at 600.

litigation is vast, even a pro rata share of the costs may discourage potential class representatives, and encourage selective filing in districts located in states with less restrictive local rules. As the Honorable Jack B. Weinstein has explained, a federal court is not bound to enforce New York's view of what constitutes ethical professional conduct:

> Rule 23 requires, as a practical matter, that attorneys advance costs on a scale not reimbursable by any normal client. A federal court cannot allow outmoded and unrealistic concepts of ethics to inhibit it unduly in providing an effective forum to those persons of limited means who seek vindication of federal rights.

County of Suffolk v. Long Island Lighting Co., 710 F. Supp. 1407, 1413-14 (E.D.N.Y. 1989) (citation omitted), aff'd, 907 F.2d 1295 (2d Cir. 1990).

Following Rand and Lilco, the Committee on Professional Responsibility of the Association of the Bar of the City of New York concluded "that DR 5-103(b) should be inapplicable to class actions," and observed that "[i]nsisting on ultimate client responsibility would render many class action suits impracticable and have the effect of limiting the access of legitimate claims, particularly those where losses to individual claimants are very small." Committee on Professional Responsibility, Financial Arrangements in Class Actions, 20 Fordham Urb. L.J. at 848.

Neither of the cases on which the Underwriter Defendants rely involved a securities fraud class action brought under the PSLRA or suggest that DR 5-103 should be applied here. In Wilner v. OSI Collection Servs., Inc., 201 F.R.D. 321 (S.D.N.Y. 2001), an action brought under the Fair Debt Collection Practices Act ("FDCPA"), the court scheduled a hearing on the adequacy of the

class representative to address, _inter alia_, the plaintiff's fee arrangement. It noted authority for the proposition that a representative's acceptance of responsibility for her _pro rata_ share of costs would satisfy both federal and state law. _Id._ at 325-26. No written opinion followed. In _Weber v. Goodman_, 9 F. Supp. 2d 163 (E.D.N.Y. 1998), which also arose under the FDCPA, the court declined to certify a class because the named plaintiffs were not responsible for their _pro rata_ share of the costs and expenses as required by Rule 5-103(B). _Id._ at 174.

While the minimal recovery available to each plaintiff under the FDCPA creates legitimate concern regarding client control of the litigation, those issues are separately addressed in federal securities law actions by the oversight regime established by the PSLRA. Enforcing DR 5-103 in the context of this securities class action would undermine the purposes of both the PSLRA and Rule 23. Requiring the named plaintiffs to shoulder their _pro rata_ share of what are sure to be substantial expenses is unnecessary in this context. In appointing lead plaintiff and approving co-lead counsel, the Court carefully evaluated NYSCRF's willingness and ability to shepherd this litigation. There is no indication that the assumption by their attorneys of the financial risk of litigation has diminished NYSCRF's diligence in supervising the lawsuit.

(c) _Lead Plaintiffs vs. Class Representatives_

The Underwriter Defendants contend that each of the named plaintiffs other than NYSCRF is inadequate because it was not selected as a lead plaintiff under the PSLRA process. They point

out that the PSLRA uses the criteria from Rule 23 to guide the selection of the most adequate plaintiff to lead the class. The defendants reason that a plaintiff cannot, therefore, serve as a named plaintiff unless it has been selected as a lead plaintiff pursuant to the PSLRA process.

The PSLRA does not prohibit the addition of named plaintiffs to aid the Lead Plaintiff in representing the class. As discussed above, the PSLRA promotes the selection at an early stage of the litigation of an institutional investor with the largest financial stake in the action so that that investor can control the course of the litigation. See In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *25-27. The PSLRA lead plaintiff provisions ensure that securities litigation is driven by investors, not lawyers: it is not a process designed to select the most adequate complaint or a substitute for the class certification process, which almost invariably comes later.

The consolidated pleading filed by NYSCRF included claims on behalf of bondholders. Joinder of such claims was entirely proper, see id. at *27, but prudence dictated that named plaintiffs be added to assist in the representation of the bondholders since NYSCRF did not purchase either the 2000 or 2001 Notes. Although the lead plaintiff must "otherwise satisfy the requirements of Rule 23," nothing in the text of the PSLRA indicates that every named plaintiff who satisfies the requirements of Rule 23 must also satisfy the criteria established under the PSLRA for appointment as lead plaintiff and actually be appointed as a lead plaintiff. Appointment of a lead

plaintiff and certification of the class occur at two different stages of the litigation, and are to be reviewed under the separate standards that govern each process. See, e.g., In re Initial Public Offering Sec. Litig., 214 F.R.D. 117, 123 (S.D.N.Y. 2002); In re Oxford Health Plans, Inc. Sec. Litig., 199 F.R.D. 119, 125 (S.D.N.Y. 2001).

(d) Supervision of the Litigation

The Underwriter Defendants contend that neither Fresno nor FCERA is an adequate representative since neither is sufficiently informed about the litigation nor sufficiently involved in supervising it. "Both class representatives and class counsel have responsibilities to absent members of the class," Maywalt v. Parker & Parsley Petroleum Co., 67 F.3d 1072, 1077 (2d Cir. 1995), and a court must be satisfied that the named plaintiffs will "fairly and adequately protect the interests of the class" before it may certify the class. Id. (quoting Fed. R. Civ. P. 23(a)). "Attacks on the adequacy of a class representative based on the representative's ignorance," however, have been "expressly disapproved of" by the Supreme Court. Baffa, 222 F.3d 52, 61 (citing Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 370-74 (1966)). Plaintiffs are entitled to rely on the "expertise of counsel," County of Suffolk, 710 F. Supp. at 1416, and a class representative will be found inadequate due to ignorance only when they "have so little knowledge of and involvement in the class action that they would be unable or unwilling to protect the interests of the class against the possibly competing interests of the attorneys." Baffa, 222 F.3d at 61 (citation

omitted); see also Cromer, 205 F.R.D. at 124. In the end, "[t]he ultimate responsibility to ensure that the interests of class members are not subordinated to the interests of either the class representatives or class counsel rests with the district court." Maywalt, 67 F.3d at 1078; see also Grant v. Bethlehem Steel Corp., 823 F.2d 20, 23 (2d Cir. 1987).

In challenging the adequacy of Fresno and FCERA's supervision of the litigation, the Underwriter Defendants rely exclusively on the deposition testimony of Gary Peterson ("Peterson"), the former auditor, controller, treasurer/tax collector and retirement administrator for the County of Fresno, who was deposed as a Rule 30(b)(6) witness for both Fresno and FCERA. Peterson retired in January of this year. He had only limited knowledge about the litigation. Nonetheless, he did express an understanding that as class representatives, Fresno and FCERA were responsible for representing all members of the class, including those who bought both debt and equity securities, and offered even while in retirement to "do whatever is necessary to represent the class."

Peterson's successor at Fresno, its "Auditor-Controller/Treasurer-Tax Collector", discussed the pleadings and retainer agreements in this case with Fresno's attorneys and determined that Fresno should continue to act as a class representative. Her affidavit demonstrates an understanding of the litigation and Fresno's role in it, and her on-going assistance to Fresno's attorneys in monitoring and prosecuting this action on behalf of Fresno. Similarly, Peterson's successor

at FCERA, its "Retirement Administrator," discussed the draft consolidated class action complaint with outside counsel, examined the retainer agreement, and determined that FCERA should serve as a class representative. His affidavit indicates an understanding of the litigation, and reflects that he has been monitoring and assisting counsel since he assumed his role in October 2002.[26]

The evidence shows that FCERA and Fresno are committed to this litigation, are willing to represent the interests of the class, and that they understand their responsibilities as class representatives. While the defendants fault these named plaintiffs for deferring to lead plaintiff and for relying on their own counsel to interact with NYSCRF's counsel, these named plaintiffs are in fact cooperating in the efficient management of the litigation. Because of the great identity of issues that affect both stock and bond holders there is no need for the additional named class representatives to duplicate the work of

[26] The Underwriter Defendants have moved to strike the affidavits of the current Fresno and FCERA employees that were submitted in support of the plaintiffs' reply papers. The Underwriter Defendants argue that these affidavits should have been submitted with the plaintiffs' original motion papers. There was no need to submit these affidavits in support of the motion. The affidavits were submitted to respond to that portion of the attack on Peterson which focused on his current lack of knowledge (and supervision) of the litigation, and to show that his successors at each entity are currently supervising the litigation. The defendants' attack relies substantially on the deposition they took of Peterson during the discovery conducted in connection with the motion to certify. The defendants were informed before taking Peterson's deposition that he was retired, but that he was the person most knowledgeable about, inter alia, the investment strategies employed by Fresno and FCERA during the Class Period. The motion to strike is denied.

lead plaintiff. Indeed, if they tried to do so, they would risk criticism. When it comes, however, to those issues that directly affect the bondholders, including any settlement and damage issues, there is no reason to believe that FCERA and Fresno will not be diligent and appropriately aggressive in protecting the interests of those they represent.

B. The Rule 23(b)(3) Requirements

(1) Common Questions Predominate

Under Rule 23(b)(3), a class may be certified only where "questions of law or fact common to the members of the class predominate over any questions affecting only individual members." Rule 23(b)(3), Fed. R. Civ. P. The predominance requirement evaluates whether a proposed class is cohesive enough to merit adjudication by representation. See Moore, 306 F.3d at 1252. Predominance will be established if "resolution of some of the legal or factual questions that qualify each class member's case as a genuine controversy can be achieved through generalized proof, and if these particular issues are more substantial than the issues subject only to individualized proof." Id. Consequently, to determine whether common questions of law or fact predominate, a court must focus "on the legal or factual questions that qualify each class member's case as a genuine controversy . . . [and] test[] whether proposed classes are sufficiently cohesive to warrant adjudication by representation." Amchem Prods., 521 U.S. at 623; see also In re Visa Check/MasterMoney, 280 F.3d at 135. The predominance requirement

is "readily met" in many securities fraud actions. Amchem Prods., 521 U.S. at 625.

The defendants' arguments concerning predominance are addressed to the claims against them brought under Sections 11 and 12(a)(2) of the Securities Act and Section 10(b) of the Exchange Act. They do not dispute that most of the elements necessary to establish liability for these causes of action are common to the class. In addition, although not addressed by the defendants, their most readily available defenses to liability also present issues of law and fact that are common to the class. The Underwriter Defendants argue that these common questions do not predominate, however, principally because of issues related to reliance in connection with the Section 11 claim based on the 2000 Notes, and because of damage issues for both the Sections 11 and 12(a)(2) claims. The SSB Defendants argue principally that a presumption of reliance should not apply to the two Section 10(b) claims against them, and therefore, that individual issues will predominate over common ones.

The plaintiffs have shown that the many common legal and factual issues at stake in this litigation will predominate even when the arguments raised by the defendants in this connection are carefully considered. A description of the statutes and their elements illustrates why the common questions will overwhelm the proof and legal issues at trial.

(a) Section 11

Section 11 of the Securities Act provides that any underwriter may be liable if "any part of the registration

statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . .” 15 U.S.C. § 77k(a).[27] Section 11 imposes a stringent standard of liability on those who play “a direct role in a registered offering.” Herman & MacLean v. Huddleston, 459 U.S. 375, 381-82 (1983). See DeMaria v. Andersen, 318 F.3d 170, 175 (2d Cir. 2003). Purchasers may sue if they purchased at the time of the initial public offering, id. at 176, or if they are "aftermarket purchasers who can trace their shares to an allegedly misleading registration statement." Id. at 178.

Those who purchase within twelve months after the registration statement becomes effective, and at any time until there is an earning statement "covering a period of at least

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[27] Section 11 states in pertinent part:

> [i]n case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . may sue --
> (1) every person who signed the registration statement;
> (2) every person who was a director of . . . the issuer . . .
> (4) every accountant . . . who has with his consent been named as having prepared or certified any part of the registration statement . . .
> (5) every underwriter with respect to such security.

15 U.S.C. § 77k.

twelve months beginning after the effective date of the registration statement" need not prove reliance in order to recover. 15 U.S.C. § 77k(a)(5). Section 11 provides in this regard:

> If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the securities relying on such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

15 U.S.C. § 77k(a)(5) (emphasis supplied). See DeMaria, 318 F.3d at 176.

The "earning statement" that triggers the requirement of proof of reliance may consist of "one report or any combination of reports" either on SEC Forms 10-K, 10-KSB, 10-Q, 10-QSB, and 8-K, or in the annual report to securities holders issued pursuant to Rule 14a-3 of the Exchange Act. 17 C.F.R. § 230.158(a)(2). The report or reports comprising the "earning statement" must, however, include the specific information required by the SEC as set forth in Item 8 of Forms 10-K and 10-KSB (17 C.F.R. § 249.310), part I, Item 1 of Forms 10-Q 10-QSB (17 C.F.R. § 249.308a), or Rule 14a-3(b) (17 C.F.R. § 240.14a-3(b)). See 17 C.F.R. 230.158(a)(1). As the SEC regulations explain, form filings may not contain material omissions.

> The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light

> <u>of the circumstances under which they are made, not misleading</u>.

17 C.F.R. § 210.4-01(a) (emphasis supplied).[28] In addition, "financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate . . . ." 17 C.F.R. § 210.4-01(a)(1). Thus a filing, including a quarterly or annual report that may constitute an "earning statement" for purposes of Section 11, must include the requisite material disclosures and be prepared in accordance with generally accepted accounting principles.

There is an affirmative defense to a Section 11 claim allowing a defendant to prove that the loss in the value of a security is due to something other than the alleged misrepresentation or omission. Section 11(e), 15 U.S.C. § 77k(e), provides:

> That <u>if the defendant proves</u> that any portion or all of such <u>damages represents other than the depreciation in value of such security resulting from such part of the</u>

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[28] SEC regulations require Form 10-Q interim financial statements to "include disclosures . . . . sufficient so as to make the interim information presented not misleading." 17 C.F.R. § 210.10-01. The regulations explain that

> Disclosures should encompass, for example, significant changes since the end of the most recently completed fiscal year in such items as: accounting principles and practices; estimates inherent in the preparation of financial statements; status of long-term contracts; capitalization including significant new borrowings or modification of existing financing arrangements . . . .

17 C.F.R. § 210.10-01(a)(5).

> registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable.

15 U.S.C. § 77k(e) (emphasis supplied). A defendant's burden in establishing this defense is heavy since "the risk of uncertainty" is allocated to defendants. Akerman v. Oryx Communications, Inc., 810 F.2d 336, 341 (2d Cir. 1987); see also McMahan & Co. v. Wherehouse Entertainment, Inc., 65 F.3d 1044, 1048-49 (2d Cir. 1995).

Section 11 also provides an affirmative defense of due diligence, which is available to defendants other than the issuer of the security. See Herman & MacLean, 459 U.S. at 382; Chris-Craft Indus. Inc. v. Piper Aircraft Corp., 480 F.2d 341, 369-71 (2d Cir. 1973). It provides that a defendant other than the issuer will not be liable if he proves that

> he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . .

15 U.S.C. § 77k (b)(3) (emphasis supplied).

(b) Section 12(a)(2)

Section 12(a)(2) of the Securities Act (formerly Section 12(2)) allows a purchaser of a security to bring a private action against a seller that "offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue

statement of a material fact or omits to state a material fact necessary in order to make the statements . . . not misleading." 15 U.S.C. § 77l(a)(2). Section 12(a)(2) imposes liability without requiring "proof of either fraud or reliance." Gustafson v. Alloyd Co., 513 U.S. 561, 582 (1995). A plaintiff need only show "some causal connection between the alleged communication and the sale, even if not decisive." Metromedia Co. v. Fugazy, 983 F.2d 350, 361 (2d Cir. 1992) (citation omitted). "Reliance by the buyer need not be shown, for § 12(2) is a broad anti-fraud measure and imposes liability whether or not the purchaser actually relied on the misstatement." Id. (citation omitted).

There is an affirmative defense for a Section 12(a)(2) claim that parallels that available for a Section 11 claim. The statute prohibits recovery to the extent that

> the person who offered or sold such security proves that any portion or all of the amount recoverable . . . represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communications, with respect to which liability of that person is asserted . . . .

15 U.S.C. § 77l(b).

Also like Section 11, Section 12(a)(2) provides an affirmative defense of due diligence. See Royal American Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1019 (2d Cir. 1989). A defendant shall not be found liable if he "sustain[s] the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission" which is "necessary in order to make the statements, in

light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77l(a)(2) (emphasis supplied).

(c) Section 10(b)

Section 10(b) of the Exchange Act serves as a "catchall provision." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206 (1976). It creates a cause of action for manipulative practices by defendants who act in bad faith. Section 10(b) provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange - . . .
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). Rule 10b-5 describes what constitutes a manipulative or deceptive device under Section 10(b). Rule 10b-5 states that it is unlawful for any person, directly or indirectly:

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5; see also Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 534 (2d Cir. 1999).

To state a claim pursuant to Section 10(b) and Rule 10b-5, a plaintiff must allege that "the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused injury to the plaintiff." Lawrence v. Cohn, 325 F.3d 141, 147 (2d Cir. 2003) (quoting Ganino v. Citizens Util. Co., 228 F.3d 154, 161 (2d Cir. 2000)); see also Kalnit v. Eichler, 264 F.3d 131, 138 (2d Cir. 2001). The form of reliance required to state a Section 10(b) claim is of particular relevance with respect to defendants' arguments in opposition to class certification.

To prevail on a Section 10(b) claim a plaintiff must demonstrate that her injuries were caused by the defendant's material misstatements or omissions. See Emergent Capital Investment Management, LLC v. Stonepath Group, Inc., 343 F.3d 189, 196 (2d Cir. 2003); Castellano v. Young & Rubicam, Inc., 257 F.3d 171, 179 (2d Cir. 2001); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 534 (2d Cir. 1999). "[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, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 95 (2d Cir. 2001)(emphasis in original); see also Castellano, 257 F.3d at 186-87; Grace v. Rosenstock, 228 F.3d 40, 46 (2d Cir. 2000). Section 10(b) requires both that plaintiffs

"would not have entered the transaction but for the misrepresentations and that the defendants' misrepresentations induced a disparity between the transaction price and the true 'investment quality' of the securities at the time of transaction." Suez Equity, 250 F.3d at 97-98 (emphasis in original).

"Like reliance, transaction causation refers to the causal link between the defendant's misconduct and the plaintiff's decision to buy or sell securities. It is established simply by showing that, but for the claimed misrepresentations of omissions, the plaintiff would not have entered into the detrimental securities transactions." Emergent, 343 F.3d at 197 (citation omitted). In securities fraud claims, reliance is presumed when the claim rests on the omission of a material fact. See Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972); Castellano, 257 F.3d at 186; Press, 166 F.3d at 539. Even with respect to material misrepresentations, reliance may be presumed through the doctrine known as the fraud on the market presumption.

The fraud on the market presumption arose as a practical response to the difficulties of proving direct reliance in the context of modern securities markets, where impersonal trading rather than a face-to-face transaction is the norm. With the presumption, a plaintiff need not prove that she read or heard the misrepresentation that underlies her securities claim. Rather, she is presumed to have relied on the misrepresentation

by virtue of her reliance on a market that fully digests all available material information about a security and incorporates it into the security's price. See Basic, Inc. v. Levinson, 485 U.S. 224, 243-44 (1988). The market in effect acts as the agent of the investor, informing her that, "given all the information available to it, the value of the stock is worth the market price." Id. at 244 (citation omitted). As Congress observed, "[t]he idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings [sic] about a situation where the market price reflects as nearly as possible a just price." Id. at 246 (quoting H.R. Rep. No. 1383, at 11); see also Cromer, 205 F.R.D. at 129. The fraud on the market theory rests

> on the notion that fraud can be committed by any means of disseminating false information into the market.... Because the fraud on the market may taint each purchase of the affected stock, each purchaser who is thereby defrauded ... is defrauded by reason of the publicly disseminated statement. If such a straightforward cause and effect is not a connection, then the Rule would not punish a particularly effective means of reducing the integrity of, and public confidence in, the securities markets. The 'in connection with' language [in Rule 10(b)-5] was chosen in an effort to broaden the reach of the Rule to achieve precisely these aims.

In re Ames Dept. Stores Inc. Stock Litig., 991 F.2d 953, 967 (2d Cir. 1993); see also SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860-62 (2d Cir. 1968).

The presumption is a rebuttable one. A defendant can show, for instance, that "an individual plaintiff traded or would have traded despite his knowing the statement was false," or can make

"[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price . . . ." Basic, 485 U.S. at 248.

According to the Basic Court, the presumption is supported by several interlocking rationales, including the assistance the presumption provides in managing cases in which direct proof of reliance is difficult, as well as fairness, judicial economy, common sense, and the probability that the presumption reflects reality. Id. at 245-47. Courts presume reliance "where it is logical to presume that reliance in fact existed." Chris-Craft Indus., 480 F.2d at 375. In Basic, the presumption permitted certification of a class action in a securities fraud case. It permitted the trial court to find that the common questions predominated over the particular questions pertaining to individual plaintiffs, such as their individual reliance. Basic, 485 U.S. at 242, 247.[29]

As the Second Circuit recently observed during a discussion of the doctrine of forum non conveniens,

> A strong public interest favors access to American courts for those who use American securities markets. The fraud on the market theory itself illustrates investors' reliance on accurate and complete

[29] Prior to the development of the law establishing in appropriate cases a presumption of reliance, the Second Circuit had held that the Rule 23(b)(3) predominance standard would still be met even if it were necessary to provide separate trials on reliance, at least where the defendants' alleged misrepresentations were standardized. See Green v. Wolf Corp., 406 F.2d 291, 301 (2d Cir. 1968).

> information. [citing Basic at 245-47] . . . . As the statute explaining the need for regulation and control of transactions in securities exchanges and over-the-counter markets states, these transactions are "affected with a national public interest." Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78b. Thus, those laws must also be applied consistently with regard to the significant majority of the putative class who bought their securities on American markets.

DiRenzo v. Philip Servs. Corp., 294 F.3d 21, 33 (2d Cir. 2002).

Much like the tort law concept of "proximate cause," loss causation means "that in order for the plaintiff to recover it must prove the damages it suffered were a foreseeable consequence of the misrepresentation." Suez Equity, 250 F.3d at 96; see also Emergent, 343 F.3d at 197; Castellano, 257 F.3d at 186; Manufacturers Hanover Trust Co. v. Drysdale Sec. Corp., 801 F.2d 13, 21 (2d Cir. 1986). The "foreseeability finding turns on fairness, policy, and 'a rough sense of justice.'" AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202, 217 (2d Cir. 2000) (quoting Palsgraf v. Long Island R. Co., 248 N.Y. 229, 352 (1928)). Determining whether a loss was a foreseeable consequence of a particular defendant's actions is, ultimately, a public policy question, which asks how far back along the causal chain liability for the plaintiffs' losses should extend. Suez Equity, 250 F.3d at 96; AUSA Life Ins. Co., 206 F.3d at 210. In assessing loss causation allegations, courts ask "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). "If the loss was caused by an intervening event, like a general fall in the price of Internet

stocks, the chain of causation will not have been established." Emergent, 343 F.3d at 197. Recently, the Second Circuit reaffirmed its "established requirement that securities fraud plaintiffs demonstrate a causal connection between the content of the alleged misstatements or omissions and the harm actually suffered." Id. at 199.

(2) Predominance Finding

The claims based on Sections 11 and 12(a)(2) of the Securities Act and Section 10(b) of the Exchange Act are based on a common nucleus of facts and a common course of conduct.[30] The common questions for trial include whether WorldCom's statements and public filings, including its Registration Statements for the 2000 and 2001 Notes, and SSB's analyst reports contained material, untrue statements and omissions. For the Section 10(b) claims, they include whether the defendants acted with the requisite scienter and whether the misrepresentations and omissions caused the plaintiffs' losses. These common questions of fact and law will predominate over any questions affecting individual class members.

As noted, however, the Underwriter Defendants argue that individualized issues of reliance will predominate in connection with the trial on a portion of the Section 11 claim and that

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[30] It is also true that common questions of law and fact will predominate as to the likely defenses that will be presented at trial, such as, whether the underwriters were sufficiently diligent and whether causes other than the alleged misrepresentations and omissions contributed to the decline in the prices of WorldCom's securities.

individualized issues of damages will predominate in connection with the Sections 11 and 12(a)(2) claims. The SSB Defendants argue that individualized issues of reliance will predominate in connection with the Section 10(b) claims brought against them. They are both wrong. Their arguments are addressed below.

(a) The Section 11 Claim & the 2000 Offering

The Underwriter Defendants argue that each plaintiff who purchased the 2000 Notes after August 14, 2001 -- that is, after an "earning statement" covering more than 12 months from the effective date of the 2000 Registration Statement -- will have to establish her specific and individual reliance on the 2000 Registration Statement.[31] The Underwriter Defendants contend that this is an issue that will affect many class members. Their expert estimates that over fifty-five percent of the investors in 2000 Notes acquired at least some of their investment in the Notes after August 14, 2001. Indeed, named plaintiff Fresno is one of the entities that acquired its 2000 Notes after that date, although it acquired its bonds at a premium and before the decline in the price of the bonds that began in late January 2002.

[31] The defendants have not argued that there was a qualifying earning statement for the 2001 Offering. The last of the documents comprising the 2000 Registration Statement was filed with the SEC on May 19, 2000, and the last of the documents comprising the 2001 Registration Statement was filed on May 11, 2001. The existence of the accounting fraud was disclosed by at least June 25, 2002.

As described above, any "earning statement" under Section 11 must comply with the governing SEC regulations. It must include, for instance, such “material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading," and be prepared “in accordance with generally accepted accounting principles.” 17 C.F.R. § 210.4-01(a). In 1983, in connection with a final rule defining an earning statement for purposes of Section 11 to include statements of income in a combination of multiple documents, the SEC reaffirmed this principle when it noted that it was "[p]ermitting one or any combination of Exchange Act reports <u>containing the required information</u> for statements of income to satisfy the 'earning statement' requirement" of Section 11. Definition of Terms, Securities Act of 1933 Release No. 33-6485, 1983 SEC LEXIS 717, at *6 (Sept. 23, 1983) (emphasis supplied).

WorldCom has admitted that its financial statements from 1999 through the first quarter of 2002 overstated earnings by over $9 billion. WorldCom's admissions leave no doubt that the earning statements filed with the SEC from 1999 through the first quarter of 2002 were misleading and omitted material information required by the SEC to be disclosed.

An earning statement that violates the SEC filing requirements should not be considered an “earning statement” for purposes of Section 11, and should not function in a Section 11 claim to shift to the plaintiff the burden of proving reliance.

It would be illogical indeed if any filing -- no matter how inaccurate or misleading, and despite its perpetuation of the very misrepresentations at stake in the Section 11 claim -- were sufficient to shift the burden to the plaintiffs to establish reliance on the Registration Statement. Whether a filing is sufficient to shift the burden must depend on whether it meets the requirements for earning statements imposed by the SEC rules and regulations. Here, because the earning statement requirements were not met, the burden does not shift to plaintiffs to prove reliance.

(i) The Fraud on the Market Presumption

Even if an admittedly flawed WorldCom SEC filing were considered an "earning statement" for purposes of Section 11, however, issues common to the class would continue to predominate. The fraud on the market presumption should apply to the plaintiffs' Section 11 claims, just as it does to the Section 10(b) claims.

It appears that few courts have addressed whether a presumption of reliance may apply to a Section 11 claim. The two that have considered the issue, both coming before the Supreme Court's decision in Basic in 1988, refused to apply it. In In re Storage Tech. Corp. Sec. Litig., 113 F.R.D. 113 (D. Col. 1986), the court refused to apply the presumption to a Section 11 claim based on an employee stock option plan, since an employee's reliance would depend on their access to "inside knowledge." Id. at 121. In Greenwald v. Integrated Energy, 102 F.R.D. 65 (S.D.

Tex. 1984), although the court refused to apply the presumption to a Section 11 claim "because to do so would eliminate the plaintiff's already minimal burden of proof," it nonetheless held that common issues predominated. Id. at 71. Without discussing whether a presumption of reliance could apply, two other courts have found that common questions would predominate even though some plaintiffs would have to show reliance. See In re Data Access Systems Sec. Litig., 103 F.R.D. 130, 147 (D.N.J. 1984) (finding plaintiff who purchased before the earning statement adequate to represent those who purchased after); Weiss v. Tenney Corp., 47 F.R.D. 283, 289-90 (S.D.N.Y. 1969) (named plaintiff purchased both before and after earning statement).

It would also be true here that common questions would predominate even if some plaintiffs would have to show reliance in connection with some or all of their bond holdings. Nonetheless, it is unlikely that proof of individual reliance will be required. The reasons behind the creation of the presumption for securities fraud claims apply with equal force to the Section 11 claims brought here.

The reasons identified in Basic that drove the adoption of the presumption in the context of a Section 10(b) claim also support its application to the plaintiffs' Section 11 claim. Section 11 requires those who purchase after the twelve-month earning statement to show reliance on the registration statement, but it does not require direct proof of that reliance. 15 U.S.C. § 77k(a)(5). Indeed, the statute itself makes explicit that even

when a plaintiff must demonstrate reliance, she has no burden to so do by showing that she actually read the registration statement. 15 U.S.C. § 77k(a)(5).

Section 10(b) claimants must also show reliance, and, where there is an open and developed market for the securities, they are entitled to the presumption of reliance discussed above. There is no dispute that the market for WorldCom securities was an open and developed market, including the market for Worldcom bonds. When Section 11 claimants made their purchases they relied, as did Section 10(b) claimants, on all public information about WorldCom's financial condition insofar as it was reflected in the market price of the WorldCom securities. The uncorrected 2000 Registration Statement was among the sources of public information reflected in the market price of WorldCom securities, including the price of the 2000 Notes purchased in the aftermarket. Just as Section 10(b) claimants are entitled to a presumption of reliance in these circumstances, if those who purchased 2000 Notes after August 14, 2001 must also show reliance, they should have the ability to invoke the same presumption. Indeed, to discriminate in this regard between the Section 10(b) and Section 11 claimants, at least in this action, would make little sense. As in Basic, 485 U.S. at 246-47, fairness, judicial economy, common sense and probability all support adoption of a rebuttable presumption of reliance on the 2000 Registration Statement.

The Underwriter Defendants contend that those who purchased after a twelve-month earning statement cannot be presumed to have relied on the 2000 Registration Statement, regardless of whether the subsequent earning statements were accurate. When Congress added the requirement to Section 11 in 1934 that a plaintiff show reliance on a registration statement after an intervening earning statement has been issued, it acted because of the "likelihood" that "the purchase and price of the security purchased after publication of such an earning statement will be predicated upon that statement rather than upon the information disclosed upon registration." H.R. Conf. Rep. 73-1838, at 41 (1934). The Underwriter Defendants cite commentary that draws on Congress's rationale to suggest that the price "would reflect the results revealed in the earnings statement, whether or not correct." Arnold S. Jacobs, Disclosure & Remedies Under the Securities Laws § 3.38 (2003). That is, of course, true. The market price of a security will reflect all public sources of information, including the statements made in registration statements and earning statements. Jacobs himself observes, however, that a Section 11 plaintiff "should be able to use any form of proof of reliance available under Rule 10b-5," including the presumption of reliance available under the fraud on the market theory. Id. (emphasis supplied). Even after the dissemination of an earning statement, the registration statement remains among the sources of information affecting the market price of the security and, certainly in the circumstances of this case, where there was an

open and developed market in WorldCom securities and no curative disclosure in the earning statement, reliance on the 2000 Registration Statement may be presumed.

(ii) Short Selling & the Fraud on the Market Presumption

The Underwriter Defendants argue that an unusually large proportion of investors had more short than long positions in WorldCom bonds. They conclude that, since investors with net short positions will have difficulty meeting the reliance element of the Section 11 claim, the presumption should not apply.

This argument rests on the analysis of their expert Lucy P. Allen ("Allen") of the trading by certain investors in five months in 2002, beginning in late January. The price of all WorldCom securities, including the 2000 and 2001 Notes, began to decline in late January 2002, and continued to decline through June 25, 2002, the date on which the Class Period ends. Allen analyzed the investments of 454 investors who purchased bonds from the 2000 Offering.[32] She also analyzed the investments of 831 investors who purchased bonds from either the 2000 or 2001 Offering. She gathered the trading data for these investors from all of their accounts held at any of four major banks. Allen concluded,[33] based on an examination of every account held at the

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[32] Among the categories of investors that Allen excluded from her analysis were those that have filed individual actions.

[33] Allen's report is somewhat opaque. Even when the tables that accompany her report are studied, it is not always clear what Allen was measuring or how she performed her analysis. As a

four banks by these investors, that of those that held a position in either the 2000 or 2001 Notes, thirty-five percent had an "overall or net short position" in those bonds on every day from January 30 until June 25, 2002, and forty-three percent had a net short position as of June 25, 2002. Of those who purchased any of their 2000 or 2001 Notes after January 30, 2002,[34] twenty-eight percent had a net short position in the 2000 and 2001 Notes as of June 25, 2002.

Allen does not explain precisely what she measured to conclude that a position was "short." For example, the 2000 Offering included bonds with maturity dates of November 26, 2001, and May 15, 2003, 2006, and 2010. She does not explain how she balanced, for instance, a short position in a 2003 bond against a long position in the 2006 or 2010 bond. In any event, to the extent that an investor was "short" and profited from the decline in the value of WorldCom securities, then that investor is not part of the class. The class is defined to include only all persons who purchased WorldCom securities from April 29, 1999 through June 25, 2002, and "who were injured thereby." Of course, those investors on the opposite side of the short, that is, those who bought WorldCom bonds, would have lost money and are part of the Class.

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consequence, this summary is the Court's best attempt to understand what she purported to find.

[34] Allen does not indicate how many investors there are in this sub-class.

Allen’s report, in addition to being cryptic, may be fundamentally flawed. Her analysis only includes investors' holdings at the four institutions whose records she studied, even though many institutional investors have accounts at multiple investment firms and banks. Since Allen’s analysis considers only a limited field of information, there is no assurance that the picture of investors' portfolios it presents is accurate, and evidence that it is not. Two examples will suffice. HGK was one of the individual investors whose trading data was included in Allen’s report. Because HGK also held its investments at institutions other than the four included in Allen’s report, she only had a portion of its investments to study and erroneously listed it as being short by almost $13 million in bonds as of June 25, 2002, when in fact it was never short. Similarly, Allen listed at least five substantial investors, with investments ranging in size from approximately $25 to $59 million, as holding a short position without change for over a year. It is far more likely that these investors had purchased their bonds through another institution and simply sold their bonds through one of these four institutions whose records Allen studied and no longer held <u>any</u> bonds.

A court may consider expert evidence at the class certification stage, but "may not weigh conflicting expert evidence or engage in 'statistical dueling' of experts." <u>In re Visa Check/MasterMoney</u>, 280 F.3d at 135 (quoting <u>Caridad</u>, 191 F.3d at 292-93). The court must ensure that "the basis of the

expert opinion is not so flawed that it would be inadmissible as a matter of law," id., and must use it not to evaluate the merits of the case, but to determine whether the requirements of Rule 23 have been met. Id. The question is whether the expert evidence demonstrates the existence or absence of common questions of fact warranting class certification, not whether it will be persuasive at trial. See id.

It is unnecessary to discuss in more detail Allen's reports, including the one submitted with the Underwriter Defendants' surreply, or the critique of her analysis offered by plaintiffs' expert. Essentially, the Allen analysis is offered to support two findings. First, the report is offered to show that there was extensive short selling during five months in 2002. Second, relying on that fact, defendants reason that the short selling means that in 2002 a number of investors were betting that WorldCom would default on its bond obligations, and thus were not counting on the reliability of the market price or on the alleged misrepresentations about WorldCom's financial condition.[35]

The existence of short selling, even voluminous short selling in five months in 2002, however, does not suggest that the presumption of reliance should not apply to those who

[35] If a bondholder shorted some bonds while holding long positions in other bonds that does not necessarily indicate a belief that WorldCom would not be able to meets its bond obligations. It may be more indicative of a desire to profit in the short run from the decline in the market price that occurred in all WorldCom securities between late January and June 2002.

purchased the 2000 Bonds and lost money. A bondholder who shorted WorldCom bonds and made money or broke even on her investments is not part of the Class. Should investors who are members of the Class and who acquired their WorldCom bonds after the twelve-month earning statement bear any burden at trial to establish reliance on the 2000 Registration Statement, they would be able to invoke the presumption of reliance for their Section 11 claims as discussed above.[36] And, even if the presumption of reliance did not apply, the plaintiffs have shown that the many common questions of law and fact at issue here will predominate at trial.

(b) Oral Representations & Section 12(a)(2)

The Underwriter Defendants contend that common issues will not predominate since Section 12(a)(2) of the Securities Act also protects investors who purchased bonds based on oral representations. It is not entirely clear from the defendants' brief argument on this issue what they are suggesting. As described above, the plaintiffs need not show reliance to bring a Section 12(a)(2) claim. See Gustafson, 513 U.S. at 582; Moore, 306 F.3d at 1253. In any event, no allegations in the Amended

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[36] The cases on which the defendants rely are inapposite. Faktor v. American Biomaterials Corp., 1991 WL 336922 (D.N.J. May 28, 1991), held that the fraud on the market presumption would not apply to common law claims, and refused to certify a class because of issues of individual reliance. Id. at *12-13. In In re PaineWebber Sec. Litig., 151 F.R.D. 248 (S.D.N.Y. 1993), the class representative had a conflict since it had engaged in short-sales. Id. at 249.

Complaint or submissions from the defendants identify any oral statement by WorldCom or the defendants that contradicted the alleged misrepresentations in the prospectuses. In this Securities Litigation, the plaintiffs' allegations arise from consistent misrepresentations and omissions and not from individualized negotiations and representations from salespeople.[37] Neither the allegations themselves nor defendants' submissions raise issues of individual solicitation that threaten to dominate the class claims.

(c) Section 10(b), Reliance & the SSB Defendants

The SSB Defendants contend that the presumption of reliance cannot apply to the Section 10(b) claims in Counts IX and X because it cannot apply to expressions of opinion by a research analyst since it is not probable or likely that such opinions would affect the market price for WorldCom securities. They also contend that the presumption of reliance cannot apply to what they describe as the "Conflict-of-Interest Claim" because the market had long been aware of the conflicted relationship between WorldCom and SSB, and there is therefore no reason to presume

[37] The only two cases on which the Underwriter Defendants rely are entirely inapposite. In McMerty v. Burtness, 72 F.R.D. 450 (D. Minn. 1976), sales were accomplished primarily during face-to-face meetings between the parties. The court found that "the primary impetus for a sale was the personal confrontation." Id. at 455. The second case on which the Underwriter Defendants rely is even farther afield. Ingenito v. Bermec Corp., 376 F. Supp. 1154, 1169 (S.D.N.Y. 1974), addresses the purchase and sale of herds of cattle through individual contracts negotiated between each cattleman and salesman.

reliance on the failure to describe the purported conflict in the analyst reports. They argue that for each of these reasons each class member will have to prove her individual reliance on the analyst reports, and that as a result common issues will not predominate at trial.

The argument by the SSB Defendants emerges from several false premises. First, the SSB Defendants distinguish what they term the "Conflict-of-Interest Claim" from the "Complicity Claim."[38] In fact, there is no conflict of interest "claim," and there is no separate complicity "claim," at least as the SSB Defendants define it. Instead, the Amended Complaint has a Section 10(b) claim based on the statements and omissions in the Registration Statements for the 2000 and 2001 Offerings (Count IX), and a Section 10(b) claim based on the SSB analyst reports (Count X).

Count IX alleges that SSB and Grubman had a conflicted relationship with WorldCom that had the effect of forming a conspiracy among WorldCom, Ebbers, Sullivan, SSB and Grubman, and that as part of that conspiracy SSB and Grubman participated in a scheme to misrepresent WorldCom's financial condition in

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[38] This argument is similar to that made by the SSB Defendants when they unsuccessfully moved to sever Counts IX, X and XI. At that time, the Court ruled that it was "inaccurate to classify, as SSB does, the 'center of gravity' for Counts IV and V as being the 'financial' issues and for Counts IX through XI as being the 'analyst' issues. Financial reporting and analyst issues permeate all five counts" against the SSB Defendants. In re WorldCom, Inc. Sec. Litig., 2003 WL 1563412, at *3 (S.D.N.Y. Mar. 25, 2003).

connection with the 2000 and 2001 Offerings. SSB was a lead underwriter and book manager for both Offerings.

Count X alleges that SSB and Grubman engaged in a scheme to misrepresent WorldCom's true financial condition in order to obtain lucrative work from WorldCom. It asserts, inter alia, that Grubman directed Ebbers to make untrue statements about WorldCom's financial condition and then issued analyst reports to reinforce those misleading statements. The analyst reports are asserted to be misleading not only in their description of WorldCom's financial condition, but also in their failure to disclose SSB's conflicted relationship with WorldCom.

As this brief outline illustrates, the allegations regarding the quid pro quo relationship are integral to both of the claims that Grubman and SSB made false statements and material omissions in violation of Section 10(b). The relationship between SSB and WorldCom is used in the Amended Complaint, inter alia, to explain why the SSB Defendants were willing to misrepresent WorldCom's financial condition to the public, both through the Registration Statements and through the analyst reports. As alleged in the Complaint, there is also a synergy between the misrepresentations and omissions on the one hand, and both the public perception of the value of WorldCom securities and the decline in the price of WorldCom securities on the other hand. See In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *33.

A second false premise relates to the argument by the SSB Defendants that the plaintiffs must prove reliance on the

defendants' failure to disclose the illicit relationship. There is no burden to prove reliance on an omission. See Affiliated Ute, 406 U.S. at 153-54; Castellano, 257 F.3d at 186; Press, 166 F.3d at 539. Reliance is presumed if the omission or non-disclosure is material. Affiliated Ute, 406 U.S. at 153-54; Castellano, 257 F.3d at 186. SSB tries to avoid the Affiliated Ute presumption by suggesting that plaintiffs must prove reliance because the omitted information was tied to the misrepresentations about WorldCom's financial condition in the analyst reports since the failure to disclose bolstered the credibility of the reports. While the omissions and misrepresentations are alleged to be interdependent in their significance and effect, it remains true that the description of the relationship at issue here was omitted from the analyst reports, that the description of WorldCom's financial condition was not a description of the relationship, and that reliance on material omissions is presumed.

Third, the arguments presented by the SSB Defendants are entirely dependent on highly contested facts. The briefs of the SSB Defendants ignore the detailed factual allegations in the Amended Complaint in favor of their own selective presentation of facts and argument. For example, they argue that since no regulator has asserted that the SSB Defendants knew of or

participated in the fraud,[39] then the plaintiffs will not succeed in showing that they were participants. They argue that Grubman's reports could not have had an impact on the price of WorldCom securities since he was a mere analyst, and only one of thirty-five reporting on WorldCom. They argue that the market was already saturated with disclosures about Grubman's conflict of interest in his relationship with WorldCom.[40] The motion for class certification is simply not the correct forum to resolve hotly contested factual disputes.

Fourth, certain of the arguments presented by the SSB Defendants would have been more appropriately raised in their motion to dismiss, and were not. For example, they argue that a Section 10(b) claim cannot be brought against anyone but an issuer, and certainly not against an analyst. The defendants cite no legal authority to support this remarkable assertion. There is, in any event, no legal barrier to bringing a Section

[39] Although the investigation was not specific to the WorldCom fraud, SSB and Grubman were the subject of an investigation into the undue influence of investment banking on securities research conducted by the SEC and the New York State Attorney General's Office and other governmental and regulatory entities. Citigroup paid $400 million in settlement in connection with the investigation.

[40] For example, the SSB Defendants argue that the fact that the 2000 Registration Statement disclosed that SSB was taking a position in excess of $2 billion in the Notes being offered was sufficient to disclose its financial interest in the successful marketing of the securities being offered. The plaintiffs point out that there was no disclosure during the Class Period of the "hot" IPO shares given by SSB to Ebbers and Sullivan, or of the hundreds of millions of dollars of loans from Travelers to Ebbers, among other things.

10(b) claim against an analyst. See, e.g., In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *32; In re Credit Suisse First Boston Corp. Sec. Litig., No. 97 Civ. 4760 (JGK), 1998 WL 734365, at *5-6 (S.D.N.Y. 1998); In re WRT Energy Sec. Litig., No. 96 Civ. 3610 (JFK), 1997 WL 576023 at *11 (S.D.N.Y. Sept. 15, 1997). There are innumerable cases in which Section 10(b) claims have been brought against speakers who are not issuers.

The SSB Defendants argue essentially that it would be inappropriate to apply the presumption of reliance to a Section 10(b) claim brought against an analyst because statements by a non-issuer are not "likely" to affect the market price. They point out that Basic approved the presumption of reliance in that case because the presumption was consistent with common sense and probability. Basic, 485 U.S. at 246-47; Cromer, 205 F.R.D. at 128-29. They assert that it is consistent with neither to do so here. To make this argument, the SSB Defendants ignore virtually every allegation in the lengthy Amended Complaint (as well as evidence uncovered through discovery and submitted in support of this motion).[41] At no point in their briefs do they acknowledge Grubman's alleged role as the premier analyst in the telecommunications industry. Nothing in the defendants' briefs

[41] The SSB Defendants have also moved to strike the factual allegations against them that were added to the Amended Complaint. That motion is denied in a separate order issued today. As the fact-bound arguments made in opposition to the motion to certify a class demonstrate, it has been helpful to have the detailed allegations against the SSB Defendants in the amended pleading.

addresses why Grubman was paid approximately $20 million a year in compensation by SSB to be its telecommunications analyst if his analyst reports were irrelevant to the market. Nothing in the defendants' briefs addresses why Grubman issued reports announcing that WorldCom was his favorite stock, offering the opinion that "we would be aggressive buyers at these prices," and "strongly" reiterating his "Buy rating on WorldCom," see In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *30 n.24, if his views were not likely to affect the decisions made by WorldCom investors. The plaintiffs have shown that it comports with both common sense and probability to apply the presumption here. The defendants may attempt to rebut the presumption at trial.

Treating the Amended Complaint as if it were an expert report, SSB's expert Dr. Robert Comment concludes from his analysis of market price movements, SEC filings, analyst reports, and news reports that the Amended Complaint does not demonstrate a causal link between Grubman's analyst reports and movements in the price of WorldCom securities.[42] SSB contends that intervening factors, specifically the collapse of the telecommunications sector and WorldCom's own disclosure of its

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[42] In response, the plaintiffs' expert, Frank Torchio, performed an event analysis which identified eighteen instances during the Class Period in which Grubman's analyst reports introduced new or unanticipated information into the market. He concluded that there was a 90% probability that Grubman's reports caused the changes in WorldCom's stock price that occurred thereafter. For the reasons explained above, it is unnecessary to wade into this battle of the experts at this point in the litigation.

accounting fraud, caused the plaintiff's losses. Although this argument may be more apt as a summary judgment argument addressed to the plaintiffs' burden to show loss causation,[43] SSB now argues that this evidence will in fact rebut the presumption of reliance at trial. Needless to say, the plaintiffs have a very different view of the relevant data and what it shows.[44] If this should in fact be treated as an argument concerning reliance, then it is one that applies equally to the entire class and does not demonstrate the existence of individual issues or overcome the predominance of the common issues. Moreover, the SSB Defendants have not sufficiently shown that Dr. Comment's

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[43] As described above, the plaintiffs will have the burden to prove at trial that the loss of which they complain was caused by the fraud they have alleged and not some intervening event. See Emergent, 343 F.3d at 197. The fraud includes the misrepresentation of WorldCom's financial condition in the Registration Statements and in the analyst reports. Consequently, the loss that occurred when the accounting fraud was disclosed is not an "intervening event." Alternatively, this argument can be characterized as an argument about whether the plaintiffs can carry their burden at trial of showing the materiality of the misrepresentations and omissions in the analyst reports. See, e.g., TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (discussing materiality under Rule 14a-9). If it is an argument about materiality, then it should have been made in connection with the motion to dismiss or may be made at the time for summary judgment. It does not, however, show that a class should not be certified.

[44] Taking the very materials on which Dr. Comment relied, the plaintiffs point, for example, to a Business Week profile of Grubman which reports that Grubman "can move billions of dollars into or out of a stock with just one research report." It quotes Grubman bragging that he was "sculpting" the telecommunications industry. The Wall Street Journal reported that a "research note" from Grubman prompted traders to buy WorldCom options.

analysis will succeed in rebutting the presumption of reliance such that it is appropriate to conclude that there will be no such presumption available at trial and that individual issues will come to predominate over common ones.

In a related argument, the SSB Defendants contend that the presumption of reliance should not apply here because the market had been aware for years that "sell-side analysts had perceived conflicts of interest arising from investment banking relationships," and because SSB disclosed its investment banking relationship with WorldCom in the disclaimer that accompanied each analyst report. See In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *34 (quoting disclaimer language contained in analyst reports). Again, the SSB Defendants ignore the detailed allegations of the illicit relationship between SSB and WorldCom. Nothing in the press reports or in the boiler-plate disclaimer on which they rely provides notice to the public of the quid pro quo relationship detailed in the Amended Complaint.[45] "A defendant

[45] The SSB Defendants rely on the most recent of the Honorable Milton Pollack's decisions in litigation relating to research reports issued by Merrill Lynch & Co. See In re Merrill Lynch & Co. Research Reports Sec. Litig., 273 F. Supp. 2d 351 (S.D.N.Y. 2003) (In re Merrill Lynch & Co. 24/7 Real Media, Inc. Research Reports Sec. Litig. & In re Merrill Lynch & Co. Interliant Inc. Research Reports Sec. Litig.) ("Merrill Lynch III"); see also In re Merrill Lynch & Co. Research Reports Sec. Litig., 214 F.R.D. 152 (S.D.N.Y. 2003) (In re InfoSpace, Inc. Sec. Litig.); In re Merrill Lynch & Co. Research Reports Sec. Litig., 272 F. Supp. 2d 243 (S.D.N.Y. 2003) (In re Merrill Lynch & Co. Global Technology Fund Sec. Litig.). Merrill Lynch III dismissed analyst-related fraud claims because plaintiffs had failed adequately to plead scienter and loss causation. 273 F. Supp. 2d at 358. Defendants rely on Judge Pollack's criticism of

may rebut the presumption . . . , [h]owever, the corrective information must be conveyed to the public with a degree of intensity and credibility sufficient to counter-balance effectively any misleading information created by the alleged misstatements." Ganino, 228 F.3d at 167 (citation omitted). Of course, any such attempt at a rebuttal does not raise individual issues, but is simply another argument with class-wide application.

The SSB Defendants also contend that the presumption of reliance cannot apply to the Section 10(b) claim based on the analyst reports (Count X) because market professionals do not rely on analysts such as Grubman in making their investment decisions,[46] because certain investment managers (including those

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the allegations arising from the analyst reports, such as his observation that the court was "utterly unconvinced" that the misrepresentations and omissions in the analyst reports had "been sufficiently alleged to be cognizable representations and omissions made with the intent to defraud." Id. Defendants make no reference to Judge Pollack's comparison of the claims in Merrill Lynch III to those in the WorldCom Securities Litigation. Id. at 364 n.25. Judge Pollack observed that, unlike the WorldCom Securities Litigation complaint, the Merrill Lynch III complaint did not allege either that Merrill Lynch possessed material nonpublic information about the financial condition of the companies it was touting or that there were undisclosed financial arrangements between Merrill Lynch and those companies of the kind alleged in WorldCom. Id. The court submitted that the WorldCom Securities Litigation May 19 Opinion was "not broad enough to cover the allegations" in Merrill Lynch III. Id.

[46] The plaintiffs have presented evidence that market professionals and portfolio managers regularly sought Grubman's views. As an example, over one thousand of them arranged to receive Grubman's "blast voicemails" about the telecommunications industry.

for some of the named plaintiffs) believed WorldCom was undervalued, because some institutional investors (again, including certain named plaintiffs) invested passively by balancing their portfolios to mimic market indices, and because fixed income investors typically rely on just a few pieces of market data (such as credit ratings and yield) in making their investment decisions. For basically the same reasons, they argue that the different categories of investors must be treated separately since they will resort to different strategies to rebut the presumption for retail investors, as opposed to program traders, short-sellers, statistical arbitrageurs, or mutual funds. These arguments reflect a fundamental misunderstanding of Basic, and the fraud on the market presumption.

The presumption endorsed in Basic is appropriate not because there is any understanding that every investor relied directly on a particular speaker, in this case, on Grubman or SSB. To the contrary, this presumption is appropriate because modern securities markets involve millions of daily transactions in which the market itself is interposed between the buyer and the seller. It is the market that transmits public information to the investor in the form of the market price. That valuation process is substantially equivalent to what an investor does for himself in face-to-face transactions. "The market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price." Basic, 485 U.S. at 244 (citation omitted)

(emphasis supplied). Consequently, "[m]isleading statements will ... defraud purchasers of stock even if the purchasers do not directly rely on the misstatements." Id. at 241-42 (citation omitted). Each of the investment strategies identified by the SSB Defendants depended directly on the publicly available information concerning WorldCom, as reflected in the price of WorldCom's securities. That publicly available information included Grubman's analyst reports.

In a final variation on this theme, the SSB Defendants argue that they are entitled to discovery of each class member and to separate trials in order to rebut the presumption of reliance. The SSB Defendants argue that separate trials would show that the individual class members would have purchased WorldCom securities at the same price that they did even if they had known of the alleged conflicts of interest since they were not relying in the first instance on Grubman's analyst reports.

For the reasons already explained above, even if the SSB Defendants could show that an individual investor had not specifically relied upon or even read the SSB analyst reports, that would not undermine the assertion of reliance. Moreover, as noted above, there is no burden to show reliance on a material omission. Finally, in addition to omitting material information regarding the illicit relationship, the analyst reports are alleged to have contained material misrepresentations regarding WorldCom's financial condition. It is also alleged that the omissions and misrepresentations were interdependent. To

successfully rebut reliance on the claim concerning the analyst reports as alleged in Count X, therefore, the SSB Defendants would have to rebut the presumption of reliance on the misrepresentations.

In sum, the SSB Defendants have not shown that the presumption of reliance should not apply to the two Section 10(b) claims against them. While the SSB Defendants may attempt to rebut the presumption at trial, they have not succeeded in showing that the presumption should not apply in the first instance. The plaintiffs have shown that it is both logical and fair to presume reliance on the statements made by the SSB Defendants in the Registration Statements and the analyst reports, and that it is appropriate to apply the presumption to the two Section 10(b) claims against the SSB Defendants.

(d) Section 10(b) Loss Causation Issues

In what they characterize as an issue relating to proof of loss causation, the SSB Defendants posit that, for their Section 10(b) claim based on the analyst reports (Count X), the plaintiffs will have to prove that those reports inflated the market price of WorldCom stock at the time of each class member's purchase.[47] Since the Class Period contains 793 trading days,

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[47] In fact, as the Second Circuit recently reaffirmed, the element of loss causation does not focus on the disparity between the price an investor pays and the investment quality of the security, but on the causal connection between the content of the misrepresentation or omission and the harm actually suffered. Emergent, 343 F.3d at 198-99.

during which many other events affected the stock market, including the terrorist attacks of September 11, 2001, they argue that this will require individualized evidence rather than class-wide proof. Relying on Merrill Lynch III, 273 F. Supp. 2d at 368 n.29, the SSB Defendants contend that the plaintiffs will have to show the impact of each of Grubman's sixty-nine analyst reports on the market, and the length of time between a report and an investor's purchase.[48]

In dismissing a securities fraud complaint, Judge Pollack held, inter alia, that the plaintiffs had failed to plead loss causation adequately. Id. at 362-68. Judge Pollack did not opine on the need to prove the length of time between each investor's purchases and an analyst report or whether such a requirement would defeat a finding that common issues in a class action would predominate over individualized ones.

The issue of loss causation is subject to class-wide proof. The plaintiffs will have the burden of showing that the misrepresentations and omissions that they have identified caused the loss of which they complain. If they carry this burden, loss

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[48] The opinion on which the SSB Defendants rely observed that the "plaintiffs make no attempt" to allege more detailed loss causation, and, later, that to support their own theory of the case, plaintiffs would have to make additional allegations. Merrill Lynch III, 273 F. Supp. 2d at 368 & n.29. The SSB Defendants neglect to mention that in an earlier footnote, the Merrill Lynch III opinion distinguishes between the analyst report allegations in the WorldCom Securities Litigation and the inadequate allegations in the Merrill Lynch III complaint. Id. at 364 n.25.

causation will be established. To the extent this argument refers to the necessity for computing an individual investor's damages, it is addressed below.

(e) Damages Issues

The Underwriter Defendants appear to argue that proof concerning damages for both the Sections 11 and 12(a)(2) claims will prevent a finding that the common issues predominate over individual issues.[49] Relying again on Allen's report, they argue that the large number of investors engaging in a short selling strategy during five months of 2002 will make it exceedingly burdensome to determine whether a plaintiff actually lost money through its investment in the WorldCom bonds issued through the 2000 or 2001 Registration Statements.[50]

This argument can be swiftly rejected. When liability can be determined on a class-wide basis, individualized damage issues

[49] The Underwriter Defendants use the term "injury" in connection with this argument. They appear to be referring to the requirement that an investor show that she suffered an economic loss in order to recover damages. For instance, they cite cases that stand for the proposition that class certification should be denied when there must be individualized analysis of whether any investor suffered an economic loss. See Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 189 (3d Cir. 2001).

[50] The Underwriter Defendants cite 15 U.S.C. § 77k(e) to support their contention that plaintiffs must show that each class member suffered a loss as a result of the actions of the Underwriter Defendants. Section 77k(e) contains an affirmative defense of disproving causation; the "heavy burden" of disproving causation is on the defendant. Akerman, 810 F.2d at 341; see also McMahan & Co., 65 F.3d at 1048.

are not ordinarily a bar to class certification.[51] See In re Visa Check/MasterMoney, 280 F.3d at 139-41 (collecting cases); In re Sumitomo Copper, 262 F.3d at 141; Green, 406 F.2d at 299 (individual reliance issues, like individual damages issues, not a bar to certification). Furthermore, the Class is defined to include only those who were injured as a result of their purchases of WorldCom securities. If an investor engaged in a strategy of shorting WorldCom securities and profited from the decline in prices in 2002, then that investor is not part of the Class.

There is no reason to believe that the proof of damages for those investors who suffered injury in their WorldCom transactions will pose any qualitatively different challenge than

[51] The cases on which the defendants rely are inapposite. For example, instead of a fraud on the market claim based on a misrepresentation or omission that affects the value of a security for all purchasers, Newton, 259 F.3d 154, addressed the implied representation of a broker to execute his client's trades to maximize the economic benefit for each client. Id. at 173. Accordingly, whether any investor suffered any economic loss depended on the specific facts surrounding each trade and whether a client had gotten the best available price. Id. at 180, 187. In La Fata v. Raytheon Co., 207 F.R.D. 35 (E.D. Pa. 2002), the only injury alleged in the proposed ERISA class action was the decision of each individual employee to remain employed during the class period. Id. at 47. Injury, therefore, hinged "upon the individual motivation and alternative job options" of the class members. Id. Finally, the court in Ganesh L.L.C. v. Computer Learning Centers, Inc., 183 F.R.D. 484, 491 (E.D. Va. 1998), found that as many as one-third of the class members were short-sellers who would need to submit individual proof of reliance. It permitted the plaintiffs to amend the class definition to exclude those who participated in short-sale transactions. Id. at 492.

is posed in the typical securities class action case. While the scale of loss and the number of investors injured may be quantitatively larger, that does not mean that the damage issues will predominate over the common issues or that the WorldCom investors should be denied the benefits of the class action vehicle. There are several management tools that a court may use "to address any individualized damages issues that might arise." In re Visa Check/MasterMoney, 280 F.3d at 141 (listing possible management tools).

(f) Statute of Limitations Defense

The SSB Defendants contend that the affirmative defense based on the statute of limitations, specifically, the one year period that governs when an investor has actual notice of the fraud alleged in a complaint, will require an individual inquiry into the knowledge of each putative class member.[52] See 15 U.S.C. § 78i(e). There is, of course, no reason to believe that any investor learned of WorldCom's accounting fraud before it was publicly disclosed. The SSB Defendants themselves take the position that they, despite their close relationship to WorldCom, remained in ignorance of the fraud. Similarly, they have not suggested how the public would have learned during the Class

[52] The first class action filed in this district was filed on April 30, 2002, nearly two months before WorldCom's June 25, 2002 disclosure of accounting irregularities. Defendants point to no particular plaintiff against whom they have a colorable statute of limitations defense, let alone a number sufficient to defeat a predominance finding.

Period of the nature and extent of the specific conflicts of interest itemized in the Amended Complaint.

The existence of this affirmative defense does not suggest that a class should not be certified in this case. Although affirmative defenses such as the statute of limitations defense may be considered as one factor in the class certification calculus, the existence of even a meritorious statute of limitations defense does not necessarily defeat certification. As the First Circuit explained in one of the cases upon which the SSB Defendants rely, Waste Management Holdings, Inc. v. Mowbray, 208 F.3d 288 (1st Cir. 2000), although the existence of an affirmative statute of limitations defense should be considered in assessing class certification,

> the mere fact that such concerns may arise and may affect different class members differently does not compel a finding that individual issues predominate over common ones. As long as a sufficient constellation of common issues binds class members together, variations in the sources and application of statutes of limitations will not automatically foreclose class certification under Rule 23(b)(3).

Id. at 296. The First Circuit affirmed the certification of the class, finding that common issues predominated despite the possibility of statute of limitations defenses.[53] Id. As in

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[53] The other case on which the SSB Defendants rely to argue that the statute of limitations issue will preclude a finding of predominance is inapposite. In Barnes v. The American Tobacco Co., 161 F.3d 127 (3d Cir. 1998), the Third Circuit found that becuase the date of accrual of each plaintiff's cause of action depended upon how much and how long each individual plaintiff had smoked, the statute of limitations defense raised individual issues. Id. at 149. In Barnes, the statute of limitations

Waste Management, despite the possible presence of statute of limitations defenses, class members in the Securities Litigation are bound by a "constellation of common issues" that predominate over any individual questions.

(3) Superiority of Class Action

Rule 23(b)(3) requires plaintiffs to demonstrate that "a class action is superior to other available methods for the fair and efficient adjudication of the controversy." Rule 23(b)(3), Fed. R. Civ. P. The factors that are relevant to an analysis of the superiority of the class action device include:

> (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

Rule 23(b)(3), Fed. R. Civ. P. This is an "nonexhaustive" list of the factors that may be relevant to the analysis of superiority. Amchem Prods., 521 U.S. at 615.

A class action is the superior method for the fair and efficient adjudication of this lawsuit. The proposed Class consists of tens of thousands of potential class members who are dispersed across the country. As a class, they have a joint

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defense was merely one of a number of individual issues, including addiction, causation, medical monitoring needs, and contributory and comparative negligence, that had the cumulative effect of rendering class certification inappropriate. Id.

interest in litigating the many common questions on which they bear the burden and in responding to the various class-wide defenses that they may face. Few individuals could even contemplate proceeding with this litigation in any context other than through their participation in a class action, given the expense and burden that such litigation would entail. If a class were not certified, most investors would be left without any recourse. Even the individual actions that have been filed against WorldCom and those related to WorldCom ("Individual Actions") represent just a fraction of investors. With few exceptions, the Individual Actions cover only bondholders, and bring suit under the Securities Act alone. Moreover, as the existence of the Individual Actions demonstrates, should shareholders and bondholders file their own individual lawsuits, such suits would risk disparate results, threaten to increase the costs of litigation for all parties exponentially, pose an enormous burden for courts throughout the land, and encourage a race to judgment to obtain the limited funds that are available to fund any recovery that plaintiffs may win here. For, however deep the pockets of the defendants, the losses suffered through the WorldCom debacle are greater.

Consideration of the factors listed in Rule 23(b)(3) as particularly relevant to the issue of superiority also demonstrates that a class should be certified. Relatively few investors have indicated a desire at this point to proceed with separate lawsuits. The Individual Actions have been filed

primarily by pension funds represented by one law firm,[54] although roughly a score of different law firms have filed at least one Individual Action. Should the pension funds ultimately decide to opt out of any certified class, they would still not represent any of WorldCom's shareholders and would represent only a fraction of its bondholders.

The benefits of concentrating this litigation in the Southern District of New York are enormous. The supervision of the litigation has resulted in great savings in litigation costs for all parties, and will preserve as much as possible of the defendants' funds to pay investors should the plaintiffs prevail. The concentration has also meant that the litigation can continue apace and that the merits of the claims can be reached as expeditiously as possible, while giving every party a fair opportunity to prepare to prosecute or defend against the claims.

Finally, as was true in Cromer, "there are no apparent difficulties that are likely to be encountered in the management of this action as a class action apart from those inherent in any hard fought battle where substantial sums are at issue and all active parties are represented by able counsel." Cromer, 205 F.R.D. at 134. The challenges in managing this litigation

[54] Milberg Weiss Bershad Hynes & Lerach LLP ("Milberg Weiss") has filed, in over twenty state courts, approximately forty separate Individual Actions on behalf of about one hundred ten public and private pension funds. Most of these actions have been removed to federal court and are in the process of being transferred to this Court by the MDL Panel.

principally derive from the existence of the Individual Actions, and the need to accommodate their interest in and right to pursue their claims alongside the class action. These challenges have been met to date, however, through the consolidation of the class and Individual Actions for pre-trial proceedings and the creation of mechanisms, such as a Liaison Counsel for the Individual Actions, so that the participation of the Individual Actions in pretrial matters is managed efficiently. See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 21242882 (S.D.N.Y. May 29, 2003) (consolidation opinion & order); In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 21219037 (S.D.N.Y. May 22, 2003) (consolidation opinion). Three discrete arguments by defendants regarding the superiority of the class action device are addressed below.

(a) Alternative Means of Recovery

The Underwriter and SSB Defendants argue that investors have so many other means of adjudicating their claims, including arbitration and individual actions, that a class action is not the superior forum for achieving recovery for their injuries. They point out that many sophisticated investors, mainly large public pension funds, have filed their own actions rather that participate in this class action.

Until a class is certified and investors must decide whether to opt out of the class it will be impossible to know who has chosen not to participate in the class action. At present, it would appear that roughly ten percent of those who purchased the

2000 and 2001 Notes are represented in Individual Actions.[55] To the extent that those same investors also purchased WorldCom stock, with few exceptions they have not chosen to include any claims based on their stock holdings.[56] All of the Individual Actions have been able to participate in the discovery taken to date through the class action with little expense or burden to themselves.

In this litigation, although scores of Individual Actions have been filed, the presence of those actions does not militate against class certification.[57] Here, the class is massive: there

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[55] No one has yet addressed in any motion filed with the Court whether an investor may opt out of the class in connection with certain of its holdings, such as its 2000 and 2001 Notes, but remain in the class for its other WorldCom investments, such as its stock purchases. The Individual Actions have avoided Exchange Act claims, such as a Section 10(b) claim, because Exchange Act claims are subject exclusively to federal jurisdiction, see 15 U.S.C. § 78a(a), and the Individual Actions are largely seeking to avoid removal to federal court and consolidation with the other WorldCom litigation. To date, removal of their actions has been accomplished pursuant to 28 U.S.C. § 1452 as "related to" the WorldCom bankruptcy. See In re WorldCom, Inc. Sec. Litig., 293 B.R. 308 (S.D.N.Y. 2003); In re WorldCom, Inc. Sec. Litig., Nos. 02 Civ. 3288, 03 Civ. 167, 03 Civ. 338, 03 Civ. 998 (DLC), 2003 WL 21031974 (S.D.N.Y. May 5, 2003).

[56] There are over twenty actions originally filed by two law firms in Mississippi state courts on behalf of separate clusters of individuals which assert claims under state law based on stock holdings.

[57] Defendants rely on three inapposite cases in which class certification was denied. In Ansari v. New York Univ., 179 F.R.D. 112 (S.D.N.Y. 1998), the plaintiff did not show that joinder was impracticable; many of the members of the small prospective class were foreign citizens whose ability to file suits in their home countries undermined the res judicata effect

is no question regarding numerosity or the impracticability of joinder. Although large private and public pension funds that are among the plaintiffs in the Individual Actions have proclaimed a willingness and ability to pursue separate litigation, less prominent class members will be unable to litigate an action on their own. Individual investors, small entities, and the many large investors who have not filed individual actions should not be deprived of their opportunity to pursue this action simply because some larger litigants with greater financial resources are presently pursuing parallel actions.

(b) Individual Issues & Manageability

The Underwriter Defendants contend that the class action device is not superior to the filing of individual actions since individual issues will predominate over common ones in any class action. Similarly, the SSB Defendants argue that a class action in this case would be unmanageable because of the existence of individual issues. They argue that discovery, for the reasons already proffered (and rejected) above, should be conducted with

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and advantage of proceeding as a class action. See id. at 115-16. In Familienstiftung v. Askin, 178 F.R.D. 405 (S.D.N.Y. 1998), the numerosity and impracticability of joinder requirements were not met; the class was small and consisted primarily of investors who were financially capable of pursuing their own actions. See id. at 409-11. Finally, in Steinmetz v. Bache & Co., 71 F.R.D. 202, 205 (S.D.N.Y. 1976), the class action was filed after nineteen other lawsuits by individual bondholders had already been brought, a number of which had been previously resolved.

respect to each class member and every different class of investors. They contend that compressing their defenses on the issues of materiality, scienter, reliance, and loss causation into one trial will deprive them of due process since each defense entails a fact-intensive inquiry dependent on evidence regarding each individual investor. They conclude that a class action will improperly relieve the plaintiffs of their burden of proof.

The defendants have not shown, for the reasons described above, that individual issues will predominate over common ones. To the extent that individual issues arise that require the Court to reconsider the certification of a class, that option is available under Rule 23. See In re Visa Check/MasterMoney, 280 F.3d at 141.

(c) Coercive Effect of Certification

Relying on Parker v. Time Warner Entertainment Co., 331 F.3d 13, 21-22 (2d Cir. 2003), the SSB Defendants argue that the coercive effect of certification, that is, the concomitant pressure to settle, will violate their rights under the Due Process Clause. They contend that this is particularly so because the plaintiffs have conflated what the defendants label as the Complicity Claim and the Conflict-of-Interest Claim. They argue that the former claim is without merit, while the latter presents substantial legal hurdles for the plaintiffs to overcome. They argue that the coupling of the two theories of wrongdoing exposes them to enormous damages for what should be a

comparatively minute award of damages, if any, on the Conflict-of-Interest Claim. The risks identified in Parker arose from the effects of combining the class action device with a statute that imposed minimum statutory damages on a per-consumer basis, the Cable Communications Policy Act of 1984. Parker, 331 F.3d at 22.

The claims in the Complaint brought against the SSB Defendants survived the motion to dismiss. The May 19 Opinion found that the Complaint sufficiently alleged scienter with respect to the analyst reports, not only for the failure to disclose the quid pro quo relationship, but also for the misrepresentations concerning WorldCom's financial condition, and that it did so with detailed allegations of both conscious misbehavior or recklessness, and of motive and opportunity, including concrete and extraordinary benefits that Grubman and SSB received as a result of their unique relationship with WorldCom. In re WorldCom, Inc. Sec. Litig., 2003 WL 21219049, at *32. "[T]he effect of certification on parties' leverage in settlement negotiations is a fact of life for class action litigants. While the sheer size of the class in this case may enhance this effect, this alone cannot defeat an otherwise proper certification." In re Visa Check/MasterMoney, 280 F.3d at 145.

The SSB Defendants have not shown that certification is improper here, and have not shown any violation of their rights under the law. This is not a strike suit filed by professional plaintiffs in order to coerce a settlement unfairly from the defendants. See Cromer, 205 F.R.D. at 134. None of the parties

dispute that a fraud occurred here. A principal issue in the trial of the Section 10(b) claims against SSB and Grubman will be whether the plaintiffs can prove the defendants' knowledge of that fraud.

(d) Class Period

Finally, if a class is certified, the SSB Defendants request that the class period for the "Conflict-of-Interest Claim" be defined to end by July 2000, or at least January 2, 2001, instead of June 25, 2002. They contend that courts truncate the class period when curative information is disseminated to the market and there is no substantial question of fact as to whether the release has "cured the market." The SSB Defendants argue that no reasonable person could dispute that the market had been warned by July 2000 (or at least January 2001) about conflicts of interest at financial services firms including SSB, and the prices for WorldCom stock continued to decline despite Grubman having continuously assigned a buy rating to it for over a year.

The two cases on which the defendants rely in fact held that class certification for the broader class period was appropriate because questions of fact remained as to whether the purportedly curative press releases effected a complete cure of the market. See Sirota v. Solitron Devices, Inc., 673 F.2d 566, 572 (2d Cir. 1982); Friedlander v. Barnes, 104 F.R.D. 417, 421 (S.D.N.Y. 1984). As these cases indicate, a class period should not be cut off if questions of fact remain as to whether the disclosures completely cured the market. See Sirota, 673 F.2d at 572.

Here, significant questions of fact remain as to whether the disclosures to which the SSB Defendants point provided an effective cure. Although press coverage indicted the independence of telecommunications analysts generally, and even Grubman in particular, crucial information particular to the relationship between SSB, Grubman, WorldCom, and Ebbers remained undisclosed during the Class Period. The Class Period runs to June 25, 2002, the date of the announcement of a $3.8 billion overstatement by WorldCom. The SSB Defendants have pointed to no disclosure to the market during the Class Period that addresses with specificity the conflict of interest alleged in the Amended Complaint. Thus, questions of fact remain as to when and how the market was informed of the allegedly lucrative and illicit quid pro quo relationship, including the existence and extent of the Travelers loans, as well as Grubman's personal involvement in SSB's investment banking generally, and in the conduct of the business of WorldCom in particular. Given these substantial questions of fact, the Class Period should end, as plaintiffs propose, on June 25, 2002, the date WorldCom announced its need to issue its first massive financial restatement.

Conclusion

The Rule 23(a) and (b)(3) requirements for certification of a class action have been satisfied. The plaintiffs' motion to certify the Class is granted.

SO ORDERED:

Dated: New York, New York
October 24, 2003

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DENISE COTE
United States District Judge