

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE WORLDCOM, INC.
SECURITIES LITIGATION

MASTER FILE NO.
02 Civ. 3288 (DLC)

This Document Relates to:

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02 Civ. 4973 02 Civ. 8234 :

**LEAD PLAINTIFF'S RESPONSE
TO ARTHUR ANDERSEN LLP'S
STATEMENT OF MATERIAL FACTS
PURSUANT TO LOCAL RULE 56.1**

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New York State Common Retirement Fund, and Co-Lead Counsel for the Class*

Pursuant to Rule 56.1(b) of this Court's Local Civil Rules, Lead Plaintiff, Alan G. Hevesi, Comptroller of the State of New York, as Administrative Head of the New York State and Local Retirement Systems and as Trustee of the New York State Common Retirement Fund, (the "NYSCRF" or "Lead Plaintiff"), together with Additional Named Plaintiffs Fresno County Employees Retirement Association ("FCERA"), the County of Fresno, California ("Fresno"), and HGK Asset Management, Inc. ("HGK"), respectfully submits the following Response Pursuant to Local Rule 56.1(b) to Arthur Andersen LLP's ("Andersen") statement of material facts submitted in support of its motion for summary judgment as to (1) the securities fraud claim ("10b-5") against Andersen and (2) the Section 11 claim against Andersen with respect to the May 2000 bond offering.

GENERAL OBJECTIONS

The following General Objections are incorporated into each specific response below as if fully repeated in each response:

1. Lead Plaintiff objects to the extent that Andersen asserts as material uncontested facts, matters that have not been the subject of discovery and therefore cannot be relied upon in moving for summary judgment under Fed. R. Civ. Proc. 56.
2. As used herein, the term "Admitted" shall mean that:
 - a. with regard to quoted language, Lead Plaintiff admits that the quote appears in the cited material(s); and
 - b. with regard to descriptions of what is in cited material(s), Lead Plaintiff admits that the descriptions accurately describe some (but not necessarily all) of the information contained in the cited material(s).

The term "Admitted" is not to be construed as a concession by Lead Plaintiff that the statement: (a) is material; (b) is complete; (c) supports the proposition for which it is cited; or (d) would be admissible at trial.

3. Lead Plaintiff reserves its right to challenge each statement as to admissibility at trial.

4. Any evidence cited in disputing a statement herein should not be construed as the only evidence of the dispute, and Lead Plaintiff specifically reserves its right to provide additional evidence as is necessary and appropriate.

RESPONSES¹

Defendant's Proposed Statement:

1. The only statements that Andersen is alleged to have made in this case are the audit opinions issued by Andersen with respect to WorldCom's annual financial statements.

Lead Plaintiff's Response:

Admitted.

Defendant's Proposed Statement:

2. Andersen's audit opinion with respect to WorldCom's 1999 financial statements was issued on March 24, 2000.

Lead Plaintiff's Response:

Admitted.

Defendant's Proposed Statement:

3. Andersen's audit opinion with respect to WorldCom's 2000 financial statements was issued on March 30, 2001.

Lead Plaintiff's Response:

¹ Reference herein to the "Ex. ___" refers to the accompanying Declaration of Jeffrey A. Barrack in opposition to Arthur Andersen LLP's motion for summary judgment and the volumes of exhibits contained therein.

Admitted.

Defendant's Proposed Statement:

4. Andersen's audit opinion with respect to WorldCom's 2001 financial statements was issued on March 7, 2002.

Lead Plaintiff's Response:

Admitted.

Defendant's Proposed Statement:

5. Andersen did not audit or issue an audit opinion with respect to any of WorldCom's quarterly financial statements.

Lead Plaintiff's Response:

Admitted.

Defendant's Proposed Statement:

6. WorldCom's 1999 financial statements were not materially misstated.

Lead Plaintiff's Response:

Denied. WCOM misapplied GAAP in accounting for its acquisition of MCI. Ex. 22 (Devor Report ¶¶ 355-357). WCOM misapplied GAAP in regards to assigning asset useful lives. Ex. 22 (Devor Report ¶¶358-360); AA198342-44; AA198318-23. WCOM improperly released accruals to reduce its reported line costs. Ex. 22 (Devor Report ¶¶34-43); AA/Citi(1):000062-65. WCOM improperly accounted for intangibles and IPR&D obtained in the MCI acquisition that resulted in erroneous amortization expenses. Ex. 22 (Devor Report ¶125). WCOM improperly recognized revenue attributed to "Network Swaps." Ex. 22 (Devor Report ¶201); 3KPMG641340005-16. WCOM previously manipulated line costs in 1997. Ex. 135 (P-2085); Ex. 11 (S. Clark N.T. at 68:5-70:25).

Defendant's Proposed Statement:

7. No Andersen auditor knew that WorldCom's 1999 financial statements were materially misstated.

Lead Plaintiff's Response:

Denied. See response to statement number 6. Lead Plaintiff further responds as follows: Andersen auditors knew that certain identifiable intangibles were not attributed any portion of the purchase price in the MCI transaction, materially misstating WorldCom's 1999 financial statements. Andersen knew or had reason to believe that WCOM depreciable lives were misstated. See Ex. 22 (Devor Report ¶¶358-365); AA198342-44; AA198318-23; Ex. 41 (AA001638); Ex. 42 (AA010341); P-2067; Ex. 38 (AA198401); Ex. 46 (AA337013-16); Ex. 49 (AA010345-353); Ex. 44. Andersen knew or had reason to believe that WCOM had misapplied GAAP in accounting for its acquisition of MCI. See Ex. 22 (Devor Report ¶¶355-357); P-2121; Ex. 31 (AA028205). Andersen knew or had reason to believe that WCOM had misstated line costs. Ex. 135 (P-20850; Ex. 11 (S. Clark N.T. at 68:5-70:25); Ex. 80. Andersen knew or had reason to believe that WCOM billing adjustment reserves were understated. See Ex. 22 (Devor Report ¶331); AA003900-05.

Defendant's Proposed Statement:

8. Andersen performed its audit of the 1999 financial statements in conformity with Generally Accepted Auditing Standards ("GAAS").

Lead Plaintiff's Response:

Denied. See responses to statement numbers 6-7. Lead Plaintiff further responds as follows: Andersen was not independent in its audit work. Ex. 22 (Devor Report ¶¶275-284); P-2050; Ex. 93; P-1202; AA011564-80; Ex. 5 (AA309364-376); Ex. 7 (Avery N.T. at 264:9-165:18). Andersen did not exercise due professional care. Ex. 22 (Devor Report ¶¶285-379); Ex. 104 (AA001395). Andersen was reckless in its audit planning and supervision. Ex. 104

(AA001425; AA001427; AA001428; AA001421). Andersen disregarded audit risk and materiality. Ex. 22 (Devor Report ¶413); AA001285. Andersen failed to properly consider the risk of material weakness in controls. Ex. 22 (Devor Report ¶¶448-464); 2KPMG300660001-242; Ex. 21; Ex. 41; Ex. 95. Andersen failed to properly utilize proper evidential matter. Ex. 22 (Devor Report ¶473); Ex. 20 (Dick N.T. at 277-278). Andersen failed to maintain proper workpapers. Ex. 22 (Devor Report ¶¶525-529).

Defendant's Proposed Statement:

9. No Andersen auditor was aware of facts that caused him or her to doubt that accuracy of the audit opinion regarding the 1999 financial statements.

Lead Plaintiff's Response:

Denied. *See* responses to statement numbers 6-8.

Defendant's Proposed Statement:

10. No Andersen auditor was on notice of facts that should have caused him or her to doubt Andersen's audit opinion regarding the 1999 financial statements.

Lead Plaintiff's Response:

Denied. *See* responses to statement numbers 6-8.

Defendant's Proposed Statement:

11. No Andersen auditor acted with scienter in connection with the audit of the 1999 financial statements, i.e., with a state of mind approximating an intent to defraud.

Lead Plaintiff's Response:

Denied. *See* responses to statement numbers 6-8.

Defendant's Proposed Statement:

12. No Andersen auditor knew that WorldCom's 2000 financial statements were materially misstated.

Lead Plaintiff's Response:

Denied. WCOM previously manipulated line costs in 1997. Ex. 135 (P-2085), Ex. 11 (S. Clark N.T. at 68:5 – 70:25). AA knew that WCOM was manipulating accruals to benefit line costs. See Ex. 22 (Devor Report ¶¶38-34). AA knew that WCOM “bled” the backbilling policy to release reserves to reduce line costs. P-2096. AA knew that there were management ordered adjusting entries made to reduce line costs, *i.e.*, the adjustment that Steven Brabbs of WCOM UK informed AA about. Ex. 79 (1BRB: 005286-87): P-2064; P-2065; Ex. 7 (Avery N.T. at 326:23 – 330:24); Ex. 1 (Schoppet N.T. at 214:3 – 225:9); Ex. 83 (Willson N.T. at 87:12 – 89:7); Ex. 81; Ex. 82. AA should have known there was a problem when it was informed by WCOM that there were no adjusting, manual, top-side entries in 2000, when there should have been. P-2149. AA was denied access to the general ledger. Ex. 119 (P-2054). AA had knowledge that WCOM used asset useful lives greatly in excess of the industry. See Ex. 22 (Devor Report ¶¶358-369). AA knew that the useful lives were not appropriate. See Ex. 22 (Devor Report ¶358); AA198342-44; AA198318-23. AA acknowledged that technology in the telecom industry changes rapidly. See Ex. 22 (Devor Report ¶359); Ex. 41 (AA001638); Ex. 42 (AA010341); P-2067. AA wrote a memo for the WCOM audit entitled “Depreciable Lives.” See Ex. 22 (Devor Report ¶360); Ex. 38 (AA198401). AA ignored information known to the engagement team that WCOM was depreciating assets, such as ocean cable, over a greater time than other companies in the telecom industry. See Ex. 22 (Devor Report ¶362); Ex. 46 (AA337013-16). AA knew that after the merger with MCI, WCOM would use the longer of depreciable lives of assets if there was a difference between the useful life at MCI versus WCOM. See Ex. 22 (Devor Report ¶363); Ex. 38 (AA198401). AA knew that management stated that it would look at the useful lives of assets, but did not in fact do a revaluation. See Ex. 22 (Devor Report ¶364); Ex. 41 (AA001639); Ex. 42 (AA010342); Ex. 47 (AA0011279-80); Ex.

48 (AA028505). AA noted that asset lives were not consistent with the telecom industry. Ex. 22 (Devor Report ¶¶365-366); Ex. 49 (AA010345-353); P-2068. AA noted that WCOM did not have effective controls on asset useful lives. Ex. 22 (Devor Report ¶367); P-2067. AA knew that the Avantel Deconsolidation was violative of GAAP. See Ex. 22 (Devor Report ¶¶378-379); AA015098; AA014899-91.

Defendant's Proposed Statement:

13. Andersen performed its audit of the 2000 financial statements in conformity with Generally Accepted Auditing Standards ("GAAS").

Lead Plaintiff's Response:

Denied. See response to statement number 12.

Defendant's Proposed Statement:

14. No Andersen auditor was aware of facts that caused him or her to doubt the accuracy of the audit opinion regarding the 2000 financial statements.

Lead Plaintiff's Response:

Denied. See response to statement number 12.

Defendant's Proposed Statement:

15. No Andersen auditor was on notice of facts that should have caused him or her to doubt Andersen's audit opinion regarding the 2000 financial statements.

Lead Plaintiff's Response:

Denied. See response to statement number 12.

Defendant's Proposed Statement:

16. No Andersen auditor acted with scienter in connection with the audit of the 2000 financial statements, i.e., with a state of mind approximating an intent to defraud.

Lead Plaintiff's Response:

Denied. *See* response to statement number 12.

Defendant's Proposed Statement:

17. No Andersen auditor knew that WorldCom's 2001 financial statements were materially misstated prior to June 2002.

Lead Plaintiff's Response:

Denied. AA knew that WCOM previously manipulated line costs in 1997. Ex. 135 (P-2085), Ex. 11 (S. Clark N.T. at 68:5 – 70:25). AA noted that WCOM claimed that there were no manual top-side adjustments when there should have been in the normal books closing process. P-2149; Ex. 119 (P-2054). AA admitted that there was no detailed version of the general ledger in the 2001 workpapers. Ex. 20 (Dick N.T. at 458-459). AA knew that the WCOM asset depreciable lives were higher than the rest of the telecom industry, *i.e.*, ocean fiber. *See* Ex. 22 (Devor Report ¶¶368-369); Ex. 49 (AA010348-49); AA029160; P-2112. AA knew that WCOM had a policy of manipulating its tax accruals in 2001 as well as their EIT rate. *See* Ex. 22 (Devor Report ¶¶370-377); P-1557; P-1558; P-1562; AA026402.

Defendant's Proposed Statement:

18. Andersen performed its audit of the 2001 financial statements in conformity with Generally Accepted Auditing Standards ("GAAS").

Lead Plaintiff's Response:

Denied. *See* response to statement number 17.

Defendant's Proposed Statement:

19. No Andersen auditor was aware of facts prior to June 2002 that caused him or her to doubt the accuracy of the audit opinion regarding the 2001 financial statements.

Lead Plaintiff's Response:

Denied. *See* response to statement number 17.

Defendant's Proposed Statement:

20. No Andersen auditor was on notice of facts prior to June 2002 that should have caused him or her to doubt Andersen's audit opinion regarding the 2001 financial statements.

Lead Plaintiff's Response:

Denied. *See* response to statement number 17.

Defendant's Proposed Statement:

21. No Andersen auditor acted with scienter in connection with the audit of the 2001 financial statements, i.e., with a state of mind approximating an intent to defraud.

Lead Plaintiff's Response:

Denied. *See* response to statement number 17.

Defendant's Proposed Statement:

22. Scott Sullivan, WorldCom's former Chief Financial Officer, was the subject of an eleven-count superseding indictment charging that Sullivan engineered a massive accounting fraud related to WorldCom's reported line cost expenses. An integral component of the fraud was concealing the fraud from, and lying to, Andersen.

Lead Plaintiff's Response:

Admitted to the extent that Mr. Sullivan was the subject of an indictment; Lead Plaintiff specifically denies Andersen's characterization of it.

Defendant's Proposed Statement:

23. On March 2, 2004, Sullivan pleaded guilty to three of the eleven counts superseding indictment, including the count charging Sullivan with concealing the fraud and lying to Andersen.

Lead Plaintiff's Response:

Admitted to the extent that Mr. Sullivan pleaded guilty; Lead Plaintiff specifically denies Andersen's characterization of Mr. Sullivan's guilty plea.

Defendant's Proposed Statement:

24. David Myers, WorldCom's former Controller, also pleaded guilty to an information in which he was charged with lying to Andersen.

Lead Plaintiff's Response:

Admitted to the extent that Mr. Myers pleaded guilty to an information; Lead Plaintiff specifically denies Andersen's characterization of the information and the guilty plea.

Defendant's Proposed Statement:

25. In addition to Sullivan and Myers, three other former senior executives at WorldCom -- Buford Yates, Jr. (Director of General Accounting), Betty Vinson (Director of Management Reporting), and Troy Normand (Director of Legal Entity Reporting) -- were charged and pleaded guilty to a conspiracy to commit securities fraud, which included concealing the fraud from the Andersen auditors.

Lead Plaintiff's Response:

Admitted to the extent that Mr. Yates, Ms. Vinson and Mr. Normand each pleaded guilty to charges; Lead Plaintiff specifically denies Andersen's characterization of any information, indictment and guilty plea.

Defendant's Proposed Statement:

26. Troy Normand, one of the conspirators, admitted to Cynthia Cooper, WorldCom's Director of Internal Auditing, that he did not notify either the internal or external auditors about the fraud at WorldCom.

Lead Plaintiff's Response:

Admitted only insofar as Mr. Normand said something to Ms. Cooper about capital expenditures and line cost accruals; Lead Plaintiff specifically denies Andersen's characterization of what was said. *See also* Cooper N.T. at 295:24-297:24; Smith N.T. at 125:17-17:25.

Defendant's Proposed Statement:

27. In the course of investigating prepaid capacity in June 2002, Farrell Malone of KMPG was advised by David Myers and Scott Sullivan that Andersen had not been informed

about the fraud.

Lead Plaintiff's Response:

Admitted only insofar as the testimony of Mr. Malone cited by Andersen in support of this statement reflects only that Mr. Myers and Mr. Sullivan did not tell Andersen about the capitalization of line costs; Lead Plaintiff specifically denies Andersen's characterization of Mr. Malone's testimony. *See* Malone N.T. at 314:21-315:15.

Defendant's Proposed Statement:

28. The only audited financial statements for WorldCom that are referred to in the registration statement for WorldCom's May 2000 bond offering are the company's 1997, 1998, and 1999 annual financial statements.

Lead Plaintiff's Response:

Admitted.

Defendant's Proposed Statement:

29. The only statements by Andersen that are referred to in the May 2000 registration statement are the audit opinions issued by Andersen with respect to WorldCom's 1997, 1998, and 1999 annual financial statements.

Lead Plaintiff's Response:

Admitted.

Defendant's Proposed Statement:

30. The Complaint makes no allegation that WorldCom's 1997 or 1998 annual financial statements or Andersen's related reports were materially false.

Lead Plaintiff's Response:

Denied. *See* Complaint at ¶¶91, 92, 241-243, 483-485.

Defendant's Proposed Statement:

31. Andersen did not issue audit opinions with respect to any of WorldCom's quarterly financial statements.

Lead Plaintiff's Response:

Admitted.

Defendant's Proposed Statement:

32. WorldCom's 1999 annual financial statements were not materially misstated.

Lead Plaintiff's Response:

Denied. *See* responses to statement numbers 6-8.

Defendant's Proposed Statement:

33. WorldCom did not restate its 1999 financial statements. In a conference before this Court on March 24, 2004, Plaintiff's counsel stated that the WorldCom "restatement has nothing to do with the 1999 financials."

Lead Plaintiff's Response:

Admitted to the extent that WorldCom did not restate its 1999 financial statements; denied as misleading specifically because the testimony of record is that the 1999 financial statements were false and were not restated because the SEC did not require restatements for the financial statements before 2000. *See* Malone N.T. at 218:4-221:5, 646:4-648:8; *see also* Heckler N.T. at 26:20-28:21, 65:22-66:4; Lindsay N.T. at 75:3-77:24. In fact, the restatement includes a restatement of the Company's opening balance as of January 1, 2000, meaning that the restatement in fact recognized that prior year financial statements had been misrepresented. *Id.* Lead Plaintiff also objects to this statement because a statement of counsel at a hearing is no basis for the assertion of proposed undisputed facts in a summary judgment proceeding. *See* responses to statement numbers 6-8.

Defendant's Proposed Statement:

34. In a conference before this Court on March 24, 2004, Plaintiff's counsel stated, "[i]magine that the restatement doesn't exist, and in this case for one of the three years at issue that is the case, '99. . ."

Lead Plaintiff's Response:

Lead Plaintiff objects to this statement because a statement of counsel at a hearing is no basis for the assertion of proposed undisputed facts in a summary judgment proceeding.

Defendant's Proposed Statement:

35. Andersen conducted the WorldCom 1999 audit in conformity with Generally Accepted Auditing Standards ("GAAS").

Lead Plaintiff's Response:

Denied. *See* response to statement number 7.

**LEAD PLAINTIFF'S STATEMENT OF MATERIAL FACTS
AS TO WHICH THERE EXISTS A GENUINE ISSUE TO BE TRIED**

1. There is a genuine issue as to whether Andersen acted with scienter in conducting each of its audits of WorldCom's 1999, 2000, and 2001 financial statements. *See* the above responses to Andersen's statement nos. 6-8, 12, 17, 26, 32-33, above; *see also* the exhibits appended to the declaration of Jeffrey A. Barrack in support of Lead Plaintiff's memorandum of law in opposition to Andersen's motion for summary judgment.

2. There is at least a genuine issue as to whether WorldCom's 1999 financial statements were false. *See* the above responses to Andersen's statement nos. 6-8, 32-33, above; *see also* the exhibits appended to the declaration of Jeffrey A. Barrack in support of Lead Plaintiff's memorandum of law in opposition to Andersen's motion for summary judgment.

Respectfully Submitted,

Dated: September 17, 2004

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