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:			:	
02 Civ. 3288	02 Civ. 4990	02 Civ. 9513	:	
02 Civ. 3416	02 Civ. 5057	02 Civ. 9514	:	
02 Civ. 3419	02 Civ. 5071	02 Civ. 9515	:	
02 Civ. 3508	02 Civ. 5087	02 Civ. 9516	:	
02 Civ. 3537	02 Civ. 5108	02 Civ. 9519	:	
02 Civ. 3647	02 Civ. 5224	02 Civ. 9521	:	
02 Civ. 3750	02 Civ. 5285	02 Civ. 2841	:	
02 Civ. 3771	02 Civ. 8226	02 Civ. 3592	:	
02 Civ. 4719	02 Civ. 8227	03 Civ. 6229	:	
02 Civ. 4945	02 Civ. 8228	03 Civ. 7298	:	
02 Civ. 4946	02 Civ. 8229	03 Civ. 7299	:	
02 Civ. 4958	02 Civ. 8230		:	
02 Civ. 4973	02 Civ. 8234		:	

REPLY MEMORANDUM OF LAW OF LEAD PLAINTIFF ALAN G. HEVESI, COMPTROLLER OF THE STATE OF NEW YORK, AS ADMINISTRATIVE HEAD OF THE NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS AND AS TRUSTEE OF THE NEW YORK STATE COMMON RETIREMENT FUND, IN RESPONSE TO MEMORANDA FILED BY DEFENDANTS ARTHUR ANDERSEN, LLP, BERT C. ROBERTS, JR. AND THE UNDERWRITER-RELATED DEFENDANTS IN OPPOSITION TO LEAD PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
Max W. Berger (MB-5010)
John P. Coffey (JC-3832)
Steven B. Singer (SS-5212)
Chad Johnson (CJ-3395)
Beata Gocyk-Farber (BGF-5420)
Jennifer L. Edlind (JE-9138)
John C. Browne (JB-0391)
1285 Avenue of the Americas
New York, New York 10019
(212) 554-1400

BARRACK, RODOS & BACINE
Leonard Barrack
Gerald J. Rodos
Jeffrey W. Golan
Mark R. Rosen
Jeffrey A. Barrack
Pearlette V. Toussant
Regina M. Calcaterra (RC-3858)
Chad A. Carder
3300 Two Commerce Square
2001 Market Street
Philadelphia, Pennsylvania 19103
(215) 963-0600

Attorneys for 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, and Co-Lead Counsel for the Class

Table of Contents

Table of Authorities

Cases **Page(s)**

Cases **Page(s)**

Lead Plaintiff, Alan G. Hevesi, Comptroller of the State of New York and the sole Trustee of the New York State Common Retirement Fund ("Lead Plaintiff" or "NYSCRF"), respectfully submits this reply memorandum of law in further support of its motion for partial summary judgment and in response to the opposing memoranda submitted by the Underwriter-Related Defendants, Arthur Andersen, and Bert Roberts.[1]

I. INTRODUCTION

On August 20, 2004, Lead Plaintiff moved for partial summary judgment on the issue of Defendants' liability under the Securities Act for the false and misleading Registration Statements for the May 2000 and May 2001 Offerings. NYSCRF's motion was supported by substantial evidence establishing that the financial statements were materially false when issued for the year end 1999, the first quarter of 2000, the year end 2000, and the first quarter of 2001. As described in greater detail in Lead Plaintiff's initial memorandum and supporting exhibits, witnesses from both WorldCom (James Renna and John Passauer) and KPMG (Farrell Malone and Brian Heckler), among others, testified to the enormous effort undertaken by WorldCom in restating the 2000 and 2001 financial statements that had earlier been audited by Andersen, and further testified to the accuracy of the Restatement filed with the SEC in March 2004. They also provided direct testimony concerning the falsity of the Company's 1999 financial statement, which was not restated only because the SEC did not require the Company to go back more than two years.

Various guilty pleas, which Defendants now appear to embrace, *see* Mem. of Law in Support of Bert C. Roberts, Jr.'s Motion for Summary Judgment as to Counts I, II & VII of Plaintiffs' Amended Complaint at 1-2 ("Roberts Moving Mem."); Arthur Andersen, LLP's Mem.

[1] Unless otherwise noted, the defined terms in this memorandum shall have the same meaning as in lead Plaintiff's opening memorandum, dated August 20, 2004 ("Opening Mem.").

of Law in Support of its Motion for Summary Judgment Dismissing the 10b-5 Claim and the Section 11 Claim with Respect to the May 2000 Bond Offering ("Andersen Moving Mem.") at 13; Underwriter-Related Defendants' Mem. of Law in Support of their Motion for Summary Judgment at 1 ("Underwriters Moving Mem."), confirm the falsity of WorldCom's financial statements for the years 2000 and 2001. Based on testimony, exhibits and his own extensive investigation, Lead Plaintiff's accounting expert, Harris L. Devor, an acknowledged expert in forensic accounting,[2] issued a report that also served as support for the summary judgment motion.

As noted above, in response to this motion, Andersen and the Underwriter Defendants relied in part upon the plea allocutions of various former WorldCom executives. These guilty pleas establish the fraud, and that WorldCom's financial statements were materially misstated at least as early as the third quarter of 2000. Defendants' reliance upon these guilty pleas, which they also cite in support of their own summary judgment motions, reinforces the conclusion that the 2000 year end and first quarter 2001 financial statements were false. The Underwriters Defendants' responses to Lead Plaintiff's Rule 56.1 statement in connection with Lead Plaintiff's summary judgment motion also admitted that the Company's financial statement for the first quarter of 2001 was false and misleading. Underwriter-Related Defendants' Response to Lead Plaintiff's Statement Made Pursuant to Local Rule 56.1 at ¶¶ 77-88.

In the course of opposing Lead Plaintiff's summary judgment motion, defendants argued that there are genuine issues of material fact relating to the falsity of WorldCom's 1999 and 2000 financial statements, and further that there is evidence supporting their "due diligence" affirmative defense under Section 11 that raise factual issues which makes summary judgment

[2] *See Malone v. Microdyne Corp.*, 26 F.3d 471, 477-78 (4th Cir. 1994) (citing to Mr. Devor's expert testimony at trial, Court of Appeals reversed judgment for defendants entered by the district court).

for Lead Plaintiff inappropriate. Defendants further cite various principles that, Lead Plaintiff submits, are equally applicable to the Defendants' own summary judgment motions, and which require the denial of the Defendants' motions. These included:

- GAAP disputes are generally issues of fact for the jury. "It is well-settled that whether GAAP has been violated is a fact-specific issue," and that "[f]requently, this determination turns on expert testimony." (Underwriters Op. Mem. at 18, *citing In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1421 (3d Cir. 1997); *Provenz v. Miller*, 102 F.3d 1478, 1490 (9th Cir. 1996), *cert. denied*, 522 U.S. 808 (1997)).

- When experts disagree, summary judgment is generally inappropriate. "Two expert affidavits, which specifically refute the other's findings, clearly present a genuine issue worthy of trial," and this "creates the proverbial 'battle of the experts,' and automatically demonstrates genuine issues of material fact for the jury to hear." (Roberts Opp. Mem. at 6, 8, *citing Hudson Riverkeeper Fund, Inc. v. Atlantic Richfield Co.*, 138 F.Supp.2d 482, 488 (S.D.N.Y. 2001); *Magique v. Chippendales, Inc.*, 628 F.Supp. 106, 107 (S.D.N.Y. 1986)).

- Questions of materiality must be resolved by the jury. As stated in the Underwriters' Opp. Mem.: "materiality must be assessed in context," " 'the issue of whether a statement or omission is material [for Section 11 liability] is usually a question for the fact finder,' " "a finding of materiality is almost *never* resolved as a matter of law," and "materiality is the *quintessential* fact question." (Underwriters Opp. Mem. at 21-22, *quoting In re Sterling Foster & Co. Sec. Litig.*, 222 F.Supp.2d 216, 263 (E.D.N.Y. 2002) (comment in brackets and emphasis in original)).

- Statements and omissions must be taken together, in context. *See, e.g.*, Underwriters Opp. Mem. at 19 (materiality of alleged misstatements in prospectus must be assessed "taken together and *in context*") (quotation omitted, emphasis in original).

The application of these principles to the factual record that has now been developed – in large part since the filing of summary judgment motions on August 20, 2004, coincident with the service of the parties' initial expert reports – demonstrates that summary judgment may not be appropriate for either Lead Plaintiff or the Defendants. As the conflicting expert reports and evidence shows, this case presents questions concerning whether WorldCom's financial statements violated the requirements of GAAP, whether Andersen's audits complied with

GAAS, and whether the Directors and Underwriters satisfied their due diligence obligations, which are quintessential matters for a jury to decide. Both sides' evidentiary submissions suggest that there may indeed be disputed questions of fact concerning the financial statements for the years 1999 and 2000, although it now appears – at the least – that all sides have admitted that the first quarter 2001, full year 2001 and first quarter 2002 financial statements of WorldCom were materially false and misleading, and issued in violation of GAAP. Underwriter-Related Defendants' Response to Lead Plaintiff's Statement Made Pursuant to Local Rule 56.1 at ¶¶ 77-88; Arthur Andersen, LLP's Counter-Statement Pursuant to Local Rule 56.1 at ¶¶ 77-88; Andersen Moving Mem. at 13; Roberts Moving Mem. at 1-2; Underwriters Moving Mem. at 1.

Thus, even if the summary judgment motions are denied, Lead Plaintiff's motion has served a central purpose of Rule 56 by narrowing the issues remaining for trial. Defendants have now conceded that the Company's financial statement for the first quarter of 2001 was materially false and misleading. *See* Andersen's Statement of Material Facts at ¶¶ 22-25; Underwriters' Statement of Material Facts at ¶¶ 91-93; 123; Roberts' Statement of Material Facts at ¶¶ 1-5. Equally significantly, Defendants have admitted that the materiality of the alleged misrepresentations and omissions must be judged together and in context, and that this presents a "quintessential" issue of fact for the jury. *See, e.g.,* Underwriters Opp. Mem. at 21, 22; Andersen Opp. Mem. at 24, 32-36.[3] Of course, the principles Defendants put forth to defeat NYSCRF's motion for partial summary judgment find equal applicability to Defendants' own summary

[3] Expert opinion by itself, however, could not establish the sufficiency of Defendants' efforts in satisfying their due diligence defense. This is because, while expert opinion may arguably be germane (although Lead Plaintiff does not concede that certain of the Defendants' experts should be allowed to give testimony on all matters contained in their reports), it is for a jury to decide whether a defendant's conduct satisfied the standard of care owed to the investing public under Section 11.

judgment motions, reinforcing the conclusion – demonstrated in Lead Plaintiff's oppositions to Defendants' motions – that Defendants are not entitled to summary judgment on their motions.

As a result, pursuant to Rule 56(d), the Court may properly resolve Lead Plaintiff's summary judgment motion by holding that certain questions have been resolved by this motion, thereby allowing the Court to continue its efforts to streamline the collection and presentation of evidence for trial. It is to that goal that Lead Plaintiff now turns.

II. ARGUMENT

A. The Court May Resolve a Motion for Summary Judgment by Determining that Certain Factual Issues Have Been Established, Even if Summary Judgment Is Not Granted

Even though the Court may find that there are issues of material fact sufficient to deny Lead Plaintiff's summary judgment motion, the Court retains the power to use the motion to establish certain facts as established for purposes of trial and resulting judgment. Rule 56(d) provides, in pertinent part:

> If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court ... shall if practicable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith contraverted. It shall thereupon make an order specifying the facts that appear without substantial controversy ... and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

The Advisory Committee Notes to the 1946 Amendment of Rule 56 further explain:

> The partial summary judgment is merely a pretrial adjudication that certain issues shall be deemed established for the trial of the case. This adjudication is more nearly akin to the preliminary order under Rule 16, and likewise serves the purpose of speeding up litigation by eliminating before trial matters wherein there is no genuine issue of fact.

The Supreme Court has expressly recognized that Rule 56(d) is a tool for courts to use in narrowing issues for trial, *Griffin v. Griffin*, 327 U.S. 220, 225-26 (1946), and courts in the

The Court is clearly empowered by Rule 56(d) to narrow contested issues for trial by deeming certain issues uncontested if it is practicable to do so. Lead Plaintiff respectfully submits that many of the issues presented to the Court by its summary judgment motion are effectively uncontested, and the Court can issue an order deeming them established for trial so that the trial may focus on issues that are genuinely in dispute.

NYSCRF will now turn to Defendants' remaining objections to its summary judgment motion.

B. The Utility of Rule 56(d) to Narrow Issues for Trial Is Not Overcome by Defendants' Assertion of an Affirmative Due Diligence Defense

Defendants contend that Lead Plaintiff's motion for partial summary judgment cannot be properly considered based upon Defendants' assertion of an affirmative due diligence defense, which, they claim, has not been effectively rebutted in Lead Plaintiff's summary judgment papers. Andersen Opp. Mem. at 40-42; Roberts Opp. Mem. at 2-4; Underwriters Opp. Mem. at 5-9. However, Defendants' argument is predicated upon a disregard of both: (1) the legal principles governing the resolution of affirmative defenses on summary judgment motions; and (2) the entire factual record in which the summary judgment motions should be considered.

First of all, Defendants' argument is based upon a failure to carefully distinguish between the *burden of production of evidence* versus the *burden of persuasion*, and the effect of the identity of the party bearing the burden of persuasion on the impact of a motion for summary judgment on the burden of production. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 331 (1986) (Brennan, J., dissenting) (agreeing with the majority's legal analysis and explaining that the manner in which the burden of production can be met depends on who will bear the burden of persuasion on the challenged claim). If, as in the present case, the burden of persuasion on this affirmative defense would be on Defendants as the *non-moving* parties, then Lead Plaintiff as the

movant can satisfy the burden of production on this summary judgment motion by either submitting affirmative evidence that negates an element of the non-moving party's claim *or* by showing that the non-moving party's evidence is insufficient. *Id.* Rule 56 has no express or implied requirement that the moving party support its motion with affidavits or other similar materials in negating the opponent's affirmative defense, *Federal Deposit Ins. Corp v. Giammattei,* 34 F.3d 51, 54 (2d Cir. 1994) (following *Celotex*); *see Frankel v. ICD Holdings S.A.*, 930 F.Supp. 54, 65 (S.D.N.Y. 1996) (*Celotex* necessarily means that one who relies on an affirmative defense to defeat otherwise meritorious summary judgment motion must adduce evidence that would permit judgment for non-moving party on the basis of that defense). Further, "the presentation of admissible evidence" by the moving party is not required, and the moving party can satisfy its burden by showing that there is "little or no evidence to support the nonmoving party's case." *Miller v. Genesco,* 1996 WL 509663, *2 (S.D.N.Y. Sept. 9, 1996), *citing Gallo v. Prudential Residential Servs., Ltd.,* 22 F.3d 1219, 1224 (2d Cir. 1994); *see Dollar Dry Dock Savings Bank v. Hudson Street Development Associates*, 1995 WL 412572, *5 (S.D.N.Y. July 12, 1995) (where non-movant bears burden of proving affirmative defenses at trial, movant not required to support its summary judgment motion with affidavits or other materials that tend to disprove non-movant's defenses).

Indeed, courts in this Circuit have repeatedly held that a party may not defeat summary judgment based upon conclusory statements, *Opals on Ice Lingerie v. Body Lines*, 320 F.3d 362, 370 n. 3 (2d Cir. 2003), or on the assertion of "some metaphysical doubt as to the material facts." *West Tsusho, Ltd. v. Prescott Bush & Co.*, 1994 WL 710798, *2 (S.D.N.Y. Dec. 20, 1994), *quoting Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986).

The second fundamental flaw with Defendants' argument is that it studiously ignores the totality of the record generated on and prior to the summary judgment motions. While Lead Plaintiff's memorandum supporting its motion for partial summary judgment was succinct in stating that Defendants cannot establish their affirmative defenses, Opening Mem. at 13, Lead Plaintiff's submission of more voluminous papers opposing Defendants' summary judgment motions (which we incorporate here by reference) demonstrates that Defendants were directly implicated in the conduct giving rise to Lead Plaintiff's claims and thus, by implication, could not possibly establish any due diligence defense (and thereby also creating a genuine issue on Defendants' affirmative defense, which compels denial of Defendants' motions as well).

C. Lead Plaintiff Properly Relied Upon Expert Analysis in Support of its Summary Judgment Motion

In a related argument, Defendants contend that Lead Plaintiff cannot satisfy its burden of production concerning the lack of evidence supporting Andersen's defense through the reports outlining the proposed testimony of its accounting expert, Mr. Devor. *See* Roberts Opp. Mem. at 8-9. Mr. Devor explained in detail in his reports the reasons and the extent to which Andersen's audits were not conducted in accordance with GAAS, and the reasons and extent to which WorldCom's financial statements – including specific line items within those financial statements – were materially false and not issued in accordance with GAAP. Defendants' argument, on one such line item, that "[t]he fact that Devor cannot find support for a particular reserve does not mean that ... such report does not exist," AA Opp. Mem. at 25, offers precisely the sort of "metaphysical doubt" the Court found insufficient in *West Tsusho*, 1994 WL 710798 at *2.

Underwriter Defendants then tender an even less weighty argument by contending that the Court must disregard Mr. Devor's analysis because it was contained in the form of a

declaration under Rule 26 (and 28 U.S.C. § 1746), rather than an affidavit under Rule 56. Underwriter Opp. Mem. at 22-23. While the disposition of this motion should not turn on such formalities, Lead Plaintiff has mooted this objection by concurrently submitting a declaration from Mr. Devor attesting, under penalty of perjury, to the statements set forth in his expert reports. *Gache v. Town of Harrison*, 813 F.Supp. 1037, 1052 (S.D.N.Y. 1993). *See* Declaration of Mark R. Rosen ("Rosen Decl.").

Andersen also contends that Mr. Devor's report is somehow flawed because he did not conduct "interviews" of key witnesses and because Lead Plaintiff did not depose certain witnesses. AA Opp. Mem. at 25. Andersen is wrong on both the law and the facts.

First, it has long been established that an expert is permitted to rely on almost any data if it is a "type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject." Fed. R. Evid. 703. Mr. Devor was not under any duty to interview witnesses because as an expert he need not rely on first-hand knowledge. *See Colon v. BIC USA, Inc.*, 199 F.Supp.2d 53, 81 n. 21 (S.D.N.Y. 2001) (expert report not unreliable because expert did not interview certain witnesses). *See also Macquesten General Contracting, Inc., v. Palmer Court Associates,* 2002 WL 31388716, at *2 (S.D.N.Y. Oct. 22, 2002) ("[E]xpert analysis is often based on reported information rather than firsthand knowledge and that is no bar to its admissibility.").

Second, contrary to Andersen's contention, the record is clear that Mr. Devor did not limit his analysis to a review of relevant documents. Mr. Devor or members of his staff also attended the depositions of key auditing and accounting personnel (including all Andersen witnesses, and the key WorldCom and KPMG witnesses). He listed the voluminous records reviewed prior to submission of his report. There is simply no requirement that Lead Plaintiff or

its experts engage in further discovery by interviewing additional witnesses to support Mr. Devor's finding of a lack of evidence supporting Defendants' positions. Indeed, Mr. Devor was present during KPMG Partner Farrell Malone's deposition, when Mr. Malone explained in particular how and why WorldCom's financial statements from 1999 through the first quarter 2002 were materially misstated and in violation of GAAP. *See* Declaration of Jeffrey A. Barrack in Support of Lead Plaintiff's Memorandum of Law in Opposition to Arthur Andersen, LLP's Motion for Summary Judgment, Exhibit 23 (Heckler N.T. at 26:20-28:21, 65:22-66:4); Exhibit 32 (Malone N.T. at 547:4-550:5, 646:4-648:8); and Exhibit 133 (Lindsay N.T. at 75:3-77:24). There is abundant evidence of record to support Mr. Devor's conclusions and Lead Plaintiff's claims.

Andersen also contends that "[Mr.] Devor's background and resume reveal no training or certifications to suggest that [Mr.] Devor has the qualifications to provide opinions as to the purchase price allocations made in connection with the MCI acquisition." Andersen Opp. Mem. at 9. Andersen is just wrong. Mr. Devor's auditing and accounting experience is varied and wide, including accounting and auditing experience related to purchase accounting. *See* Declaration of John P. Coffey, Exhibit E (Devor Report at Exhibit 1) (August 20, 2004). Similarly, Mr. Devor's expert testimony has been accepted by courts on auditing and accounting issues, including purchase accounting issues. *Id.* at Ex. 2; *see also Malone v. Microdyne*, *supra,* 26 F.3d at 478. However, to erase any doubt on this issue, Mr. Devor submitted a reply report demonstrating his experience and expertise in issues relating to purchase accounting. Rosen Decl. (Reply Report of Harris L. Devor at 16-17). In any event, as the court stated in *In re Victor Technologies Sec. Litig.*, 1987 WL 60284, at *10 n.1 (N.D. Cal. Jan. 8, 1987), "Anderson's arguments regarding Mr. [Devor's] alleged unreliability as an expert witness are properly

addressed to the jury to discredit his testimony, not to this court in a motion for summary judgment."

III. CONCLUSION

While the Court may ultimately conclude, in light of Defendants' recent submissions, that Defendants may have raised genuine issues of fact precluding summary judgment for Lead Plaintiff (as well as for Defendants on their own summary judgment motions), this Court may also rule, pursuant to Rule 56(d), that the Registration Statement for the May 2001 Offering was materially false and misleading based on Defendants' admissions that the financial statement of WorldCom for the first quarter of 2001 was false and misleading.

Dated: October 1, 2004

Respectfully submitted,

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP

Max W. Berger (MB-5010)
John P. Coffey (JC-3832)
Steven B. Singer (SS-5212)
Chad Johnson (CJ-3395)
Beata Gocyk-Farber (BGF-5420)
Jennifer L. Edlind (JE-9138)
John C. Browne (JB-0391)
1285 Avenue of the Americas
New York, New York 10019
(212) 554-1400

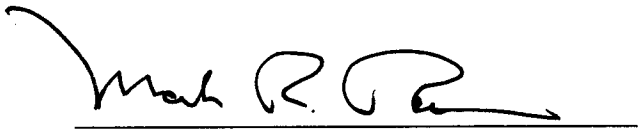
BARRACK, RODOS & BACINE

Leonard Barrack
Gerald J. Rodos
Jeffrey W. Golan
Mark R. Rosen
Jeffrey A. Barrack
Pearlette V. Toussant
Regina M. Calcaterra (RC-3858)
Chad A. Carder
3300 Two Commerce Square
2001 Market Street
Philadelphia, Pennsylvania 19103
(215) 963-0600

Attorneys for 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, and Co-Lead Counsel for the Class

CERTIFICATE OF SERVICE

I, Mark R. Rosen, hereby certify that true and correct copies of the foregoing Reply Memorandum of Law of Lead Plaintiff Alan G. Hevesi, Comptroller of the State of New York, as Administrative Head of The New York State and Local Retirement Systems and as Trustee Of The New York State Common Retirement Fund, in Support of Lead Plaintiff's Motion for Partial Summary Judgment was served on this 1st day of October, 2004, via Federal Express or first-class mail, postage pre-paid, on counsel as noted on the attached service list.



Mark R. Rosen