

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:

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

**LEAD PLAINTIFF'S MOTION *IN LIMINE* NO. 5: TO PRECLUDE  
DEFENDANTS FROM INTRODUCING EVIDENCE CONCERNING  
AN ALLEGED CONFLICT REGARDING KPMG'S AUDIT  
OF THE WORLDCOM RESTATEMENT**

Lead Plaintiff respectfully submits this motion *in limine* to preclude Defendants from introducing evidence or otherwise referring to any alleged conflict involving KPMG's audit of WorldCom financial statements or other accounting services provided to WorldCom in connection with the Restatement WorldCom issued in March 2004.<sup>1</sup>

**PRELIMINARY STATEMENT**

On May 15, 2002, WorldCom announced that its Board of Directors had ratified the Audit Committee's recommendation that WorldCom replace the Company's outside auditor,

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<sup>1</sup> Unless otherwise defined here, the defined terms used in this memorandum shall have the meaning as defined in Lead Plaintiff's Pre-trial Memorandum submitted concurrently herewith.

Andersen, with KPMG. During the time period leading up to KPMG's acceptance of WorldCom as an audit client, at least a portion of the fraud that had occurred at WorldCom was discovered, and the scope of KPMG's engagement was expanded to include the provision of audit services in connection with the preparation of the restatement of WorldCom's financial statements for the years 2000 and 2001. KPMG was further engaged to provide auditing services to WorldCom in connection with WorldCom's 2003 financial statements. The Bankruptcy Court overseeing WorldCom's bankruptcy proceedings approved the Company's engagement of KPMG for these purposes.

During the course of depositions of certain WorldCom and KPMG witnesses, Defendants have sought to impeach KPMG, and its ability to audit the Restatement, on the basis of claims that certain states had made relating to WorldCom's payments of taxes to states, and the fact that KPMG had advised WorldCom in connection with its state tax minimization program. However, those same claims of an alleged "conflict" were previously raised by certain participants in the Bankruptcy Court proceedings, and considered and rejected by Bankruptcy Judge Gonzales. *See In re: WorldCom, Inc.*, 311 B.R. 151 (S.D.N.Y. Bankr. Ct., June 30, 2004). Nonetheless, Defendants apparently will seek to introduce evidence of the alleged conflict in this trial through their deposition designations and trial exhibits. *See, e.g.*, Andersen's designation of deposition testimony of Kevin Hennessy (Rule 30(b)(6) witness for MCI relating to the state tax minimization program) (Ex. D.4 to the Joint Pre-Trial Order); Andersen's designation of deposition testimony of Farrell Malone (KPMG Engagement Partner) (*Id.*); and Andersen's identification of trial exhibits relating to the state tax minimization program and the claims of certain States against WorldCom in the bankruptcy proceeding (*Id.*).

Defendants' gambit to inject this extraneous issue into the trial of this case should be rejected by the Court. Although KPMG was involved in the restatement process at WorldCom, and issued an audit opinion letter with respect to the Restatement, it was WorldCom (n/k/a MCI, Inc.) that issued the Restatement and filed it with the SEC. Moreover, as the Bankruptcy Court explained, WorldCom did not press any claims against KPMG relating to its state tax minimization services; the SEC took no action to disapprove KPMG's retention as the Company's auditor, or reject the Restatement as filed by WorldCom; and, prior to issuance of KPMG's opinion letter, WorldCom had provided a full release of any claims that it might have brought against KPMG relating to the state tax minimization program.

Under these circumstances, allowing Defendants to raise questions concerning KPMG's independence and ability to perform its audit work would create an unnecessary and confusing side-show, distracting the jury from the genuine issues involved in this case. The submission of such evidence would further constitute an impermissible attempt to impeach a non-party on a collateral issue. *Atlas Marine Co. v. Forsikrings-Aksjeselskapet Norske Triton*, No. 92 Civ. 4746 (RPP), 1995 WL 498822, \*6 (S.D.N.Y. Aug. 22, 1995) ("witness may not be impeached by extrinsic evidence on a collateral issue"). For these reasons, and as more fully discussed below, this Court should bar defendants from offering any evidence or otherwise making any reference to the state tax minimization program or any alleged conflict arising from that program with respect to KPMG's audit of the Restatement.

### **ARGUMENT**

#### **I. FRE RULES 401, 402 AND ESTABLISHED CASE LAW ALL PROHIBIT THE INTRODUCTION OF THE CONTESTED EVIDENCE**

FRE 401 defines relevant testimony as "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or

less probable than it would be without the evidence.” See FRE 401. Rule 401 is meant to be read in conjunction with Federal Rule of Evidence 402, which provides, in part, that “[e]vidence which is not relevant is not admissible.” See FRE 402. Here, evidence regarding an alleged conflict of interest concerning KPMG’s audit of the WorldCom Restatement is irrelevant because such evidence does not “make the existence of any fact that is of consequence to the determination of the action more probable or less probable.” See FRE 401.

First, the Bankruptcy Court already determined that there is no conflict of interest that arises simply because KPMG served as both a tax advisor and auditor to WorldCom. See *In re WorldCom, Inc.*, 311 B.R. at 169-70, citing 15 U.S.C. §78j-1. In fact, Judge Gonzales noted that an accounting firm is expressly authorized by law to serve in both roles for a client, stating:

Indeed, under the applicable statutes and regulations an accounting firm is expressly permitted to act simultaneously as both auditor and tax advisor. For instance, section 10A of the Securities Exchange Act of 1934, as amended by section 201(a) of the Sarbanes-Oxley Act of 2002, specifically addresses the appropriateness of these dual roles and provides in relevant part, that a public accountant “may engage in any non-audit service, including tax services” that is not an otherwise prohibited activity under the statute. There is no indication that KPMG’s tax services qualify as a prohibited activity. Thus, the States [sic] contention that KPMG is not disinterested because it serves as both auditor and tax advisor to [WorldCom] does not appear to be well-founded and the Court, therefore, resolves this argument in favor of KPMG.

*In re WorldCom, Inc.*, 311 B.R. at 169-70. Because current law does not prohibit KPMG from assuming these dual roles, the fact that they performed such services can hardly be considered relevant under Rule 401.

Evidence of KPMG’s dual roles does not make “the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be” without such evidence, and accordingly, such evidence is inadmissible. See *Atlas Marine Co. v. Forskibrings-Aksjeselskapet Norske Triton*, No. 92 Civ. 4746 (RPP), 1995 WL 498822, \*6

(S.D.N.Y. Aug. 22, 1995); *Mullins v. Fast Motor Service, Inc.*, 35 F.3d 566, No. 92-2428, 1994 WL 475799, \*3 (6<sup>th</sup> Cir. 1994). A good example is the manner in which Defendants questioned Farrell Malone regarding the tax work performed by KPMG, in part, as follows:

Q. And can you explain to us what it is about the tax work or anything relating to the tax work that has caused the State of Massachusetts to raise an issue concerning KPMG's independence?

A. Again, it is my understanding that they have raised a disinterestedness question within the bankruptcy proceedings. I do not know the specifics of what is being asserted by the State of Massachusetts. That is handled by our legal counsel and business leaders within the firm. I have not participated in that exercise or those meetings or whatever might have been done to handle that matter. I am aware that the tax work performed by KPMG prior to our employment as the company's auditors is the issue in question.

Q. And are you aware that the independence issue that has arisen relates to potential claims that WorldCom might have against KPMG that arise out of the tax work?

A. You've used the term "independence issue." And I don't know that - - to my knowledge, I don't know that a formal independence issue has been asserted by anyone at this point. I am aware, again of the State of Massachusetts, joined by others, questioning KPMG's disinterestedness as relates to the bankruptcy. A generic independence issue, I guess I'm searching for exactly the point you're making with that.

*See* Malone Tr. at 16:23-18:10. It is clear that Defendants are attempting to insert into this litigation claims that were not only made by entities not parties to this litigation, but also claims that were asserted in another litigation, and rejected by the court that had reviewed significant briefing and heard argument on that issue. And, as explained above, in that litigation the Bankruptcy Court determined that there was no "independence" or conflict issue. *See In re WorldCom, Inc.*, 311 B.R. at 169-70. This line of questioning is not only irrelevant to the claims

and issues presented in the instant litigation, but also an impermissible attempt to impeach a witness through collateral evidence.

*Atlas Marine* involved an insurance contract under which the defendants insured the plaintiffs against the loss of use of and damage to a vessel. *Atlas Marine*, 1995 WL 498822, at \*1. There, the plaintiffs moved *in limine* to preclude the defendants from introducing at trial any evidence regarding (1) the cost of renewing the gears in another ship, (2) the defendants' contention that the vessel's gear renewal should have been completed in less time than it actually took, (3) tender bids, (4) the misalignment between the vessel's turbines and gears, and (5) the condition of the gears and gear case in 1990. *Id.* at \*6. The court granted the plaintiffs' motion because the "defendants have not shown any of this evidence could prove relevant" and because a witness cannot be "impeached by extrinsic evidence on a collateral issue." *See id.* (citing *United States v. Pugh*, 436 F.2d 222, 225 (D.C. Cir. 1970)). The issue here similarly involves Defendants' anticipated intent to impeach KPMG on the basis of extrinsic evidence on a collateral issue – not the substance of the Restatement or KPMG's work done in connection therewith but, rather, an alleged "conflict" that Defendants assert impaired KPMG's ability to perform its auditing services. As in *Atlas-Marine*, such an attempt should not be allowed in the context of The Class' claims against Defendants relating to their misconduct and lack of due diligence in connection with the issuance of false and misleading Registration Statements for the Offerings and, in the case of Arthur Andersen, its audit opinions of WorldCom's prior financial statements.

*Mullins* is similarly instructive in this regard. This case involved a personal injury action that resulted from the plaintiff's van colliding with a tractor trailer owned by the company-defendant and driven by the individual defendant. After a jury verdict for the defendants, the

plaintiff filed an appeal challenging, among other things, the district court's evidentiary rulings barring plaintiff from introducing evidence, or referring to, the individual defendant's traffic tickets and employment record. *See Mullins*, 35 F.3d 566, 1994 WL 475799 at \*1. The plaintiff argued, among other things, that counsel should have been permitted to question the individual defendant about his employment record, arguing that the employment record would have shown that the individual defendant was terminated because of his driving infractions and not because of a difference of opinion with his employer as the individual defendant had testified at trial. *Id.* at \*3. The appellate court rejected this argument, however, finding that his employment record did not make it more probable that the individual defendant had a habit of speeding and, therefore, that this line of questioning would have involved impeachment on a collateral matter. *Id.* As the Court of Appeals stated, in finding that the trial court had not abused its discretion in barring references to the defendant's traffic tickets and employment record: "Courts do not permit impeachment by extrinsic evidence of a witness on a collateral matter." *Id.*

Here, any evidence or reference to KPMG's advice to WorldCom regarding WorldCom's state tax minimization program and the alleged conflict position in which that advice had placed KPMG should similarly be excluded. In seeking to introduce such evidence – which the Bankruptcy Court has already concluded did not disqualify KPMG from auditing WorldCom's Restatement – Defendants would be attempting to impeach KPMG on a clearly collateral issue. As in *Atlas Marine* and *Mullins*, the evidence should be excluded because courts do not permit impeachment by extrinsic evidence.

## **II. THE PROFFERED EVIDENCE SHOULD ALSO BE EXCLUDED UNDER FRE 403**

Even if the evidence proffered by Defendants did not violate FRE 401 and 402, it should still be excluded under FRE 403, which provides:

Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.

Here, any claimed relevance of the proffered evidence is substantially outweighed by the danger of confusion of the issues, misleading the jury and the considerations of undue delay and waste of time. The conduct of KPMG is not at issue in this case and, as provided above, its dual services to WorldCom as its tax advisor and auditor are expressly permitted by federal law.<sup>2</sup> Thus, allowing evidence of KPMG's claimed lack of independence in performing its audit work for the Restatement would be unfairly prejudicial and extremely confusing for the jury. Where evidence would be unfairly prejudicial and extremely confusing, such evidence is properly excluded. *See, e.g., Orjias v. Stevenson*, 31 F.3d 995 (10<sup>th</sup> Cir. 1994).

In *Orjias*, the plaintiffs sued the defendant, a waterboard manufacturer, for damages stemming from claims of negligence and nuisance. *See id.* The district court entered a judgment in favor of the plaintiffs; the defendant appealed. *Id.* The defendant argued, in part, that it was reversible error for the district court to limit its cross-examination of a witness on whether the defendant had paid fines to the State of Colorado. *Id.* at 1008. The trial court had instructed the jury to disregard the testimony regarding whether the defendant had paid fines and limited any cross-examination regarding the topic because it was not an issue that was relevant to the

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<sup>2</sup> As the Class will demonstrate in response to Defendants' expected motion to exclude evidence of the Restatement, the Restatement is admissible here, for, among other reasons, because (a) it constitutes a business record of WorldCom that admits the falsity of the Company's prior financial statements, and (b) it is relevant to plaintiffs' claims that the Company materially overstated its prior financial statements. *See SEC v. Uzzi*, No. 01 Civ. 8437, 2003 U.S. Dist. LEXIS 15608, \*4-5 (S.D. Fla. Jan. 21, 2003) (admitting restatement issued by company after individual defendant had ceased employment by company). The Restatement further constitutes a reasonable basis upon which Lead Plaintiff's accounting expert relied, in part, in forming his opinions concerning the adjustments necessary to make the Company's financial statements issued during the Class Period accurate and in accordance with GAAP.



litigation, i.e., to whether the defendant was liable to the plaintiffs for damages. *Id.* at 1007. The Tenth Circuit concluded that “the district court could properly exclude it under Fed.R.Evid. 403 as a collateral matter likely to lead to confusion of the issues.” *Id.* at 1008. *See also, Scott v. Minuteman Press Int’l, Inc.*, No. 94-15140, 68 F.3d 481, 1995 WL 608489, \*\*1 (9<sup>th</sup> Cir. 1995) (trial court properly excluded introduction of evidence that constituted attempt to impeach witness on collateral issues); *Atlas Marine, supra*. For this reason, as well, where a party seeks to introduce evidence that constitutes impeachment of a witness through collateral issues, such evidence is properly excluded under Rule 403 as a matter likely to lead to confusion of the issues.

Moreover, allowing evidence of the claimed conflict would unduly delay the trial of this case. There are real claims in this case concerning, *inter alia*, the falsity of Andersen’s audit opinion letters, the falsity and misleading nature of the Registration Statements issued for the May 2000 and May 2001 Offerings, and the lack of due diligence by Defendants with respect to those Registration Statements. Allowing evidence of a claimed conflict of KPMG – a non-party – would unduly lengthen the trial of this case, as is evidenced by Defendants’ wholesale designation of the deposition of Mr. Hennessy, which was entirely devoted to this topic, and would further threaten to mislead the jury from the claims made against the defendants in this case. For this reason, as well, it should be excluded pursuant to Rule 403. *See, e.g., Guidi v. Inter-Continental Hotels Corp.*, No. 95 Civ. 9006 (LAP), 2003 WL 1907904, \*2 (S.D.N.Y. April 16, 2003) (introduction of evidence concerning facts and results of related Egyptian proceeding would create “trial within a trial” because both sides would have to present witnesses to explain Egyptian system and argue weight of various evidence). Indeed, as the court concluded in *Guidi*: “[T]his evidence, though only marginally relevant, would have the effect of wasting significant

trial time and diverting much of the jury's attention from consideration of the present case to interpretation of the Egyptian proceedings. Given the low probative value of the proffered evidence, the sideshow that would result is unwarranted." *Id.* Such is the case here.

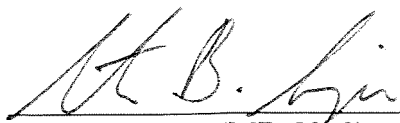
**CONCLUSION**

For all of these reasons, Lead Plaintiff respectfully requests that the Court grant this motion *in limine* and preclude Defendants from offering any evidence or otherwise referring to KPMG's state tax minimization work for WorldCom, and any alleged "conflict" relating to KPMG's audit work for the Restatement.

Dated: New York, New York  
January 7, 2005

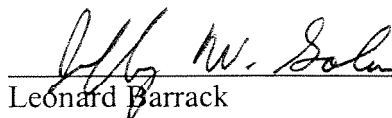
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