

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

IN RE WORLDCOM, INC. SECURITIES
LITIGATION

MASTER FILE
02 Civ. 3288 (DLC)

This Document Relates to:

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**LEAD PLAINTIFF’S MEMORANDUM IN OPPOSITION TO
ARTHUR ANDERSEN LLP’S MOTION
TO EXCLUDE CERTAIN TESTIMONY OF EUGENE MORSE¹**

Lead Plaintiff, by and through its counsel, respectfully submits this opposition to Arthur Andersen LLP’s (“Andersen”) motion to exclude certain testimony of Eugene Morse (“Morse”). Andersen does not dispute that Morse’s testimony is relevant to the claims and defenses in this case. Andersen’s motion instead challenges the basis for certain excerpted portions of Morse’s testimony that Andersen characterizes as improper expert opinion, lacking first hand knowledge, and irrelevant legal conclusions. Lead Plaintiff is not offering Morse as a Rule 702 expert witness, as Andersen argues. Any opinion testimony provided by Morse is admissible as Rule 701 lay opinion testimony because it is rationally based on his perception and experience. Finally, Morse’s colloquial style of expression is perfectly permissible under the Federal Rules

¹ Lead Plaintiff has also moved to exclude certain underwriter lay expert testimony. To the extent that the Court rules that such testimony is admissible, this would provide another basis to allow permissible fact testimony by Eugene Morse.

of Evidence, even if he uses the words “fraud” or “fraudulent” to describe practices that he believed to be deceptive. Morse’s testimony is relevant, helpful for the trier of fact to consider, and its probative value far outweighs any purported unfair prejudice. Lead Plaintiff hopes to proffer Morse as a live witness at trial, and Andersen may then pose to him any further questions it has about the basis for his testimony. For the reasons set forth more fully below, Andersen’s motion should be denied in its entirety.

I. PRELIMINARY STATEMENT

Morse earned his masters degree in business administration from Tulane University, and went on to become a chartered financial analyst, a certified internal auditor, and a certified public accountant. *See Ex. K (Morse Tr. at 9:13-10:12).*² Morse began his career at WorldCom in 1997 as part of the Financial Management Associate program. During a thirty-one month period from 1997 through January 2000 he worked in six different finance and accounting departments within WorldCom. *See Ex. K (Morse Tr. at 33:7-34:22).* Morse performed his duties in various WorldCom departments, including Internal Audit, International Settlements, Revenue Accounting, Budget, General Accounting, and Financial Planning. *See Id.* During this period of time Morse was exposed to virtually every part of WorldCom’s business. Morse decided to take a full-time position in WorldCom’s Internal Audit department in January of 2000. *See Ex. K (Morse Tr. at 43:6-18).*

As a WorldCom Senior Internal Auditor, Morse helped the department in their operational auditing functions, using his knowledge of Essbase (a software interface used to

² All exhibits referenced herein are attached to the Declaration of Jeffrey W. Golan, with Exhibits, in Support of Responses to the Motions of Arthur Andersen LLP to Exclude: (1) the SIC Report, Interview Memoranda, and the Bankruptcy Examiners Reports; (2) Reference to any of its Liability Insurance; (3) Certain Testimony of Eugene Morse; (4) the KPMG Material Weakness Letter; and (5) Andersen’s Unrelated Convictions as well as its Current Business Status, Audit Work for Other Companies that Have Been or Are the Subject of Litigation and/or Federal or State Investigation, and Settlement in Other Cases.

access the Company's general ledger) to help the department discover the wrongful "prepaid capacity" entries used to capitalize line cost expenses in WorldCom's general ledger. *See* Exhibit K (Morse Tr. at 82:19-83:14, 97:16-98:18). Contrary to Andersen's assertions that Morse never had any contact with members of the audit engagement team, Mr. Morse did have such contact and he performed an examination of Andersen's audit workpapers. *See* Exhibit K (Morse Tr. 60:14-61:13, 238:13-240:14). Given his position at the Company and his role interacting with both internal accounting and finance personnel, as well as his experience with Andersen's auditors, Morse's testimony is well founded.

Andersen's motion seeks to exclude Mr. Morse's testimony regarding (1) his opinion of "professional standards in the field of external financial auditing, and whether Andersen complied with those standards;" (2) matters as to which Andersen argues he has no personal knowledge; and (3) purported "legal conclusions." Because Andersen's motion is nothing other than an attempt to discredit properly admissible Rule 701 testimony from a witness who is clearly competent to provide it based upon his own first hand knowledge, under Rules 601 and 602, as to matters that happen to be adverse to its case, and for the reasons set forth herein, Andersen's motion should be denied in its entirety.³ *See* Ex. N (Declaration of Eugene R. Morse).

II. ARGUMENT

A. **Mr. Morse's Testimony Is Based On His First-Hand Knowledge and Is Admissible Pursuant to Rule 602**

Rule 602 provides, in relevant part, that "[a] witness may not testify to a matter unless evidence is introduced sufficient to support a finding that the witness has personal knowledge of

³ To the extent that the Court is inclined to grant any portion of Andersen's motion, Lead Plaintiff requests that the Court defer any such ruling for further opportunity for Lead Plaintiff to introduce evidence sufficient to support a finding that Mr. Morse's testimony is properly founded. Fed.R.Evid. 104(b).

the matter. Evidence to prove personal knowledge may, but need not, consist of the witness' own testimony." A witness's conclusions based on personal knowledge over time may constitute personal knowledge under Rule 602. *See New York v. St. Francis Hosp.*, 94 F.Supp.2d 423, 425 (S.D.N.Y. 2000) (citing *Securities and Exchange Comm'n v. Singer*, 786 F.Supp. 1158, 1167 (S.D.N.Y. 1992)).

In its memorandum, Andersen identifies two examples of testimony where it contends Mr. Morse testified without personal knowledge. *See* Andersen Exhibit B, #10, and Andersen Exhibit B, #15. A review of these passages shows that Morse did have personal knowledge of the events in question:

- In Andersen Exhibit B, #10, Morse testifies about an internal audit of WorldCom's international capital expenditures that Morse himself performed in the regular course of his duties as a WorldCom Senior Auditor. *See* Morse Tr. 30:10-31:7. Morse testified that during internal audits he compiled information from various sources, including his interviews with people in the field. *See* Morse Tr. 29:20-30:6. Morse's testimony in this regard is properly based on his personal observations from his work on an operational audit conducted over time focused on the Company's international capital expenditures.
- In Andersen Exhibit B, #15, Morse also testifies based on his personal observations during the course of an internal audit of the Company's wireless division. *See* Morse Tr. 238:13-239:19. Morse was able to personally review Arthur Andersen workpapers in connection with his work on the audit. *See* Morse Tr. 238:13-240:14. It is quite clear in Morse's deposition transcript that his review of the Arthur Andersen workpapers and his other work on the wireless audit allowed Morse to form conclusions about Andersen's processes and rationale related to WorldCom's bad debt reserves, particularly those in its wireless division. *See* Id.

Similarly, all of the other excerpts cited by Andersen involve Morse testifying to situations about which he has personal knowledge:

- Andersen Exhibit B, #9, is a factual account by Morse relating his first-hand knowledge of events that occurred when he worked in the revenue department at WorldCom, and his first-hand observation that WorldCom would always hit quarter-end revenue targets even though during each of those quarters the department seemed to be lagging behind its original projections. *See* Morse Tr. 26:11-27:4.

- Andersen Exhibit B, #11 and #12, continues Morse's testimony as to his observations made while working on the Company's operational audits of international capital expenditures. Morse describes his personal experience in specific detail, explaining that he *personally* had meetings and communications about the issues that make up the subject matter of this litigation with the likes of Sanjeev Sethi and David Myers. *See* Morse Tr. 31:14-32:4, 94:19-95:18.
- In Andersen Exhibit B, #14, Morse simply relates his *personal* observations of Cynthia Cooper. *See* Morse Tr. 172:23-173:12.
- In Andersen Exhibit B, #16, Morse states conclusions that he made based on his personal involvement in an audit of WorldCom's domestic capital expenditures. *See* Morse Tr. 258:5-259:4.
- In Andersen Exhibit B, #17, Morse comments on the workplace environment at WorldCom based on his work in many finance and accounting related departments, including Internal Audit, International Settlements, Revenue Accounting, Budget, General Accounting, and Financial Planning. *See* Morse Tr. 33:7-34:22, 259:25-261:9.
- Finally, in Andersen Exhibit B, #18, Morse explains his observations about the reliance that the Audit Committee of WorldCom's Board of Directors placed upon the executive management. Each of these areas of Morse's testimony is properly based on his experience as a Senior Internal Auditor at WorldCom who had significant dealings with many of the relevant individuals involved over time. *See* Morse Tr. 288:11-16, 288:19-289:2.

Because Morse's testimony constitutes conclusions and opinions made with personal knowledge pursuant to Rule 602, Andersen's motion to exclude this testimony in this regard should be denied.

B. Mr. Morse Offers Permissible Rule 701 Opinion Testimony

Rule 701 provides

If the witness is not testifying as an expert, the witness' testimony in the form of opinions or inferences is limited to those opinions or inferences which are (a) rationally based on the perception of the witness and (b) helpful to a clear understanding of the witness' testimony or the determination of a fact in issue, and (c) not based on scientific, technical or other specialized knowledge within the scope of Rule 702.

Fed.R.Evid. 701. Morse's observations that are challenged by Andersen as expert testimony are actually lay opinion testimony, and therefore, admissible under Rule 701 because his conclusions are drawn from a series of personal observations over time. *See Plastics, Inc. v. E. Creative Indus.*, 98-Civ-0884, 2004 U.S. Dist. LEXIS 2311 at *23 (S.D.N.Y. February 18, 2004) (citing 4 Weinstein & Berger, *Weinstein's Federal Evidence* § 701.03 (Joseph M. McLaughlin, ed., 2d ed. 2003)).

The excerpts of Morse's testimony cited by Andersen for exclusion are not specifically about the application of Generally Accepted Auditing Standards ("GAAS") or Andersen's compliance with those standards. Rather, the relevant portions of Morse's testimony constitute factual answers to questions that are based on Morse's personal observations and information he acquired through his personal observations on the job at WorldCom performing his duties and interacting with others. For example, the first excerpt cited by Andersen in Exhibit A is an excerpt of Morse giving a completely factual, observation-based answer that involves nothing related to compliance with GAAS or Andersen's auditing standards.

Q. Do you have an understanding as to how someone outside WorldCom could have discovered the prepaid capacity fraud that you discovered?

...

A. They could have seen a lot of the indicators that led us to the same place. If you got an Internal Audit Report that has fieldwork for three-quarters and it's showing AFE numbers for 5 billion dollars and our total for reported numbers are 7 billion dollars, that's a 2 billion dollar question you should ask the CFO or the audit committee or the – particularly the accountants. You don't – no one needed what I did. The question was there. All they needed to do was go ask it. But nobody wanted to go ask the question because they were afraid, you know, if we're wrong, we'll get our heads served to us, so let's get as much evidence as we can.

Morse Tr. 102:20-103:15. Morse is not testifying here about applicable “professional standards in the field of external financial statement auditing, and whether Andersen complied with those standards,” as Andersen argues. The testimony is about Morse’s perception of obvious facts on the face of WorldCom documents he helped to prepare during the ordinary course of his duties that someone with access to those documents could have discovered had they asked the right questions. It should be admitted for the jury to consider and evaluate.

The other excerpts Andersen challenges are also admissible.

- Andersen Exhibit A, #2, contains an excerpt where Morse directly answers a question with facts acquired using his personal observations as to entries he found performing his internal audit duties that he considered to be red flags. *See* Morse Tr. 150:24-151:15.
- In Andersen Exhibit A, #3, Morse relates his personal factual observations made while inquiring into the line cost ratios of various WorldCom competitors during the class period, and he gives no opinion regarding Andersen’s audit or professional auditing standards. *See* Morse Tr. 154:10-156:5.
- Andersen Exhibit A, #4 -#5, each contains Morse’s factual observations after observing Andersen workpapers in connection with WorldCom’s Internal Audit of Wireless Controls. Everything Morse testifies to in this regard is based on his observations from reviewing Andersen’s workpapers. *See* Morse Tr. 238:13-239:19, 256:14-257:6.
- Indeed, the excerpt contained at Andersen Exhibit A, #5(a), is a question posed by counsel for Andersen specifically asking about the company reserves being adequate on a company-wide basis. *See* Morse Tr. 278:19-279:7.
- In Andersen Exhibit A, #6, Morse gives admissible lay opinion testimony based on factual observations including (1) his observation that Andersen had classified WorldCom as a high-risk client and (2) his observation that Andersen did little substantive testing after his personal review of Andersen workpapers. *See* Morse Tr. 286:3-7, 286:13-23.⁴
- In Andersen Exhibit A, #7, Morse provides proper lay opinion testimony based on his observation of the line cost ratios of WorldCom competitors during the class period. *See* Morse Tr. 287:20-288:4, 288:7-9.

⁴ Indeed, Morse’s testimony is corroborated by Andersen’s controls-based audit approach, which only requires substantive testing where Andersen determined that residual audit risk existed.

- Andersen Exhibit A, #8, involves Morse’s opinion as to the effectiveness of the WorldCom Board of Director’s Audit Committee based on his personal observations at WorldCom, and has nothing to do with external financial auditing standards. *See Morse Tr. 288:10-16, 288:19-21.*

In each of these excerpts Morse provides either (1) factual assertions based on his personal observations or (2) permissible lay opinion testimony under Rule 701 based on those factual observations and his experience at WorldCom.

The probative value of Morse’s testimony, as well as its helpfulness to the jury, are more than sufficient to negate any claim by Andersen that it runs afoul of Rule 403 due to prejudice. The Second Circuit has made it clear that Rule 403 mandates that evidence is only prejudicial when it tends to have some adverse effect beyond tending to prove the fact or issue that justified its admission into evidence, *see, e.g., United States v. Figueroa*, 618 F.2d 934, 943 (2d Cir. 1980); it does not operate to exclude relevant evidence just because it is adverse to Andersen’s position. Morse’s testimony is not unfairly prejudicial under Rule 403. On the contrary, as Rule 701 authorizes, his testimony tends to establish facts that are otherwise in dispute.

The cases cited by Andersen in this regard are inapposite because each deals with expert testimony proffered under Rule 702 from persons claimed to have “specialized knowledge,” but whom the various court deemed as unreliable. In this case, Morse’s testimony is based on his first-hand observations at WorldCom, not on the type of “technical and other specialized knowledge” used by Rule 702 experts as a basis for their opinions. Morse’s testimony is admissible under Rule 701 and its probative value outweighs any purported unfair prejudice. For these reasons, Andersen’s Rule 403 argument should be rejected.

C. Mr. Morse’s Use of the Terms “Fraud” or “Fraudulent” Does Not Constitute a Legal Conclusion

Morse's use of the word "fraud" or "fraudulent" is not a legal conclusion because he uses the term colloquially. The Court of Appeals for the Second Circuit has held that the use of such a term in a non-legal sense does not equate to a legal conclusion. *See In re Air Disaster at Lockerbie, Scotland*, 37 F.3d 804, 826 (2d Cir. 1994), *cert. denied*, 513 U.S. 1126 (1995) (expert was permitted to testify to defendants "fraud" or "fraudulent" activity because expert was using the terms non-legally)⁵; *Adler v. Mishkin*, No. 95-08203(JLG), 1998 Bankr. LEXIS 404, at *20-21 (Bankr. S.D.N.Y. Apr. 3, 1998) (although experts cannot testify to legal conclusions, employing "those terms as a layman would in describing activity that appears to him to be deceptive or dishonest" is permissible testimony.). The testimony that Morse offered is the very type of testimony evaluated in the *Lockerbie* and *Mishkin* cases. It is simply not unfairly prejudicial, even when offered by a Rule 702 expert, when it would be accorded more weight by the jury. The admission of such testimony by a lay witness as here does not run afoul of Rule 403.

Andersen challenges Morse's testimony as inadmissible where the question or his answer contains a form of the word "fraud." In Andersen Exhibit C, # 19 and #20, Morse states what he "believed" to be fraud or fraudulent. *See* Ex. K (Morse Tr. at 24:24-25:20, 30:10-31:7). In neither of these instances does Morse use the terms "fraud" or "fraudulent" as a legal conclusion, but he is simply testifying to things he saw during the course of his employment that he believed to be "deceptive or dishonest." *See Mishkin*, 1998 Bankr. LEXIS 404, at *20-21; *Lockerbie*, 37 F.3d at 826. In Andersen Exhibit C, Andersen targets for exclusion Morse's testimony where he either uses the term "fraud" or "fraudulently" colloquially, or he doesn't use the term "fraud" at all. For example:

⁵ *In re Air Disaster at Lockerbie* was abrogated in part on other grounds by *Zicherman v. Korean Air Lines Co.*, 516 U.S. 217 (1996), but remains good law for the proposition cited above.

- In Andersen Exhibit C, #21, the only mention of “fraud” is by defense counsel questioning Mr. Morse. *See Morse Tr. 65:15-66:6*. Further, Morse’s response deals only with his 401K plan and its relation to WorldCom’s stock. *See Id.*
- In Andersen Exhibit C, #22, defense counsel specifically asks Morse to distinguish between “bad business” and “fraud.” *See Morse Tr. 94:19-95:10*.
- In Andersen Exhibit C, #23, Morse simply responds to defense counsel’s question that he never saw any evidence of fraud prior to May, 2002. *See Morse Tr. 112:17-113:8*.
- Andersen Exhibit C, #24, is also not a legal conclusion; it is relevant factual explanation of Morse’s comparison of WorldCom’s line cost E/R ratios with other telecommunications companies and what Morse concluded based on that comparison. *See Morse Tr. 154:10-156:5*.
- Finally, Andersen Exhibit C, #25 is proper lay opinion testimony about the adequacy of Andersen’s audits from the perspective of Morse’s first hand-knowledge at the company and is rationally based on his perception. *See Morse Tr. 288:11-16, 288:19-289:2*.

None of the testimony excerpts cited by Andersen in Exhibit C represent legal conclusions concerning Andersen’s audit team and/or workpapers.

Andersen’s attempt to exclude Morse’s testimony as set forth in Exhibit C is a blatant attempt to keep the jury from hearing highly probative, first-hand evidence that is damaging to their case. Rule 403 does not provide a basis for excluding highly probative evidence that just happens to be harmful to a party’s case. Because Morse used the terms “fraud” and “fraudulently” colloquially, and because such use of the term is acceptable for a lay witness in describing something he thought was deceptive or dishonest, Andersen’s motion to exclude this testimony on that ground should be denied.

III. CONCLUSION

For all of the reasons stated above, Andersen's motion to exclude certain testimony of Eugene Morse should be denied in its entirety.

Respectfully submitted,

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