

**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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**MEMORANDUM OF LAW IN RESPONSE TO ARTHUR ANDERSEN LLP’S MOTION
IN *LIMINE* TO EXCLUDE THE SIC REPORT, INTERVIEW MEMORANDA, AND
THE BANKRUPTCY EXAMINER’S REPORTS**

Lead Plaintiff respectfully submits this memorandum in response to the motion *in limine* filed by Arthur Andersen LLP (“Andersen”) to exclude from evidence the Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc. (the “SIC Report”), the interview memoranda prepared by the Wilmer Cutler attorneys, and the Reports of Richard Thornburgh, the Bankruptcy Court Examiner.¹

¹ Lead Plaintiff does not intend to introduce the interview memoranda and Thornburg Reports at trial. Accordingly, Andersen’s motion is moot as to these documents and Lead Plaintiff will not address these documents in this memorandum. Lead Plaintiff respectfully reserves the right, however, for its accounting and auditing expert to rely upon these documents. *See* FRE 703; *Nachtsheim v. Beech Aircraft Corp.*, 847 F.2d 1261, 1270 (7th Cir. 1988) (the fact that evidence is not admissible does not mean that a party’s expert is precluded from relying on it); *S.E.C. v. Price Waterhouse*, 797 F. Supp. 1217, 1220 n.8 (S.D.N.Y. 1992) (same).

PRELIMINARY STATEMENT

Contrary to Andersen's assertions, the SIC Report is admissible evidence at trial pursuant to the Federal Rules of Evidence ("FRE"). Andersen does not contend that the SIC Report is not relevant to the issues in the litigation and therefore implicitly concedes that it is relevant. Instead, Andersen argues that the SIC Report should be excluded from evidence because it constitutes hearsay and does not fall within exceptions to the hearsay rule under either FRE 803(8) (public records exception) or FRE 807 (residual hearsay exception).

Lead Plaintiff does not contend that the SIC Report falls within the parameters of FRE 803(8).² Rather, the SIC Report is a business record and therefore is admissible evidence pursuant to FRE 803(6) (business records exception). The SIC Report was issued following an exhaustive and independent investigation, which included the interview of over 100 witnesses and the review of millions of pages of WorldCom business records and accounting records. Moreover, the purpose of the report was to "provide an objective account of what happened" with respect to WorldCom's accounting fraud and it was filed with the Securities and Exchange Commission ("SEC"). The report therefore has the requisite indicia of trustworthiness necessary to be considered reliable. Accordingly, the SIC Report is admissible evidence at trial in this matter.

Andersen's secondary argument that the reports should be excluded as unfairly prejudicial pursuant to FRE 403 is without merit. Andersen utterly fails to meet the significant threshold necessary to establish unfair prejudice under FRE 403. There is nothing to suggest that the jury would imply that the report was quasi-governmental in nature. The fact that the SIC Report tends to establish that Andersen was reckless when conducting its audits of WorldCom's

² Lead Plaintiff concedes that the Special Investigative Committee was appointed by the WorldCom Board and is therefore not acting under the auspices of a public office or agency. Consequently, Lead Plaintiff does not rely upon FRE 803(8) as a basis for admitting the WorldCom Board Report into evidence in this case.

financial statements does not render the report biased, much less unfairly prejudicial.

Accordingly, FRE 403 does not provide a basis for excluding the SIC Report from evidence here.

STATEMENT OF FACTS

In WorldCom's June 25, 2002 announcement that it intended to restate certain financial statements as a result of accounting fraud, WorldCom also announced that that the Audit Committee of the Board of Directors had retained the law firm of Wilmer Cutler & Pickering (WCP) "to conduct an *independent* investigation of the matter." See Ex. A (June 25, 2002 Form 8-K (emphasis added)).³ On August 8, 2002, WorldCom issued another press release announcing more accounting irregularities and that its internal investigation was continuing. See Ex. B (August 8, 2002 Form 8-K).

On July 21, 2002, the Special Investigative Committee (the "Committee") was established by the Board of Directors. At that time, the Board of Directors authorized the Committee, which was comprised of three members who were just appointed to the Board, to "conduct a full and *independent* investigation of the accounting irregularities that gave rise to the announced intention to restate...." Ex. D (SIC Report at 2 (emphasis added)). The Committee assumed responsibility to conduct an independent investigation, and retained WCP as its counsel to provide legal advice. *Id.* at 40-41. In addition, WCP retained the well-established and experienced accounting firm PricewaterhouseCoopers LLP ("PWC") to assist with accounting issues during the investigation. *Id.*

³ 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 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.

The purpose of the Committee and its report did not include accumulating information and facts in anticipation of litigation, nor was it to identify any potential legal causes of action in order to help recover funds on behalf of WorldCom's estate. *Id.* at 3-4. In addition, the purpose of the Committee did not include investigating the propriety of relationships between WorldCom and financial analysts at Wall Street firms nor the propriety of any WorldCom public offerings during the time. *Id.* at 3, 38. Moreover, the Committee was not charged with auditing WorldCom's financial statements and was not responsible for the restatement of WorldCom's 2000 and 2001 financial statements. *Id.* at 38. Rather, the purpose of the Committee was to conduct an independent review and provide an "objective account" concerning the accounting fraud and related circumstances so that the Board could develop policies to prevent such fraud from occurring again at WorldCom. *Id.* at 37-38. In fact, William McLucas, of WCP, represented to the Bankruptcy Court that WCP was engaged to assist in the preparation of an "in-depth and unbiased report" setting forth findings of fact and conclusions with respect to the accounting fraud. *See* Ex. G (McLucas Declaration at ¶ E).

In furtherance of its investigation, the Committee interviewed 122 current and former employees and 13 former members of the Board of Directors. *See* Ex. D (SIC Report at 41). The Committee obtained and reviewed all of Andersen's audit work papers from 1999-2002 and certain desk files. *Id.* at 42, 223 n.74. The Committee also "imaged the hard drives of the computers of approximately 50 present and former WorldCom employees" and "reviewed WorldCom's General Ledger, supporting work papers, and other accounting documents." *Id.* at 41. In addition, the Committee collected over a million e-mail messages and related attachments and retrieved voicemail messages. In all, the Committee, through its legal counsel and accounting advisors, reviewed approximately two million pages of documents. *Id.*

ARGUMENT

The SIC Report is admissible evidence at trial in this case because it falls within the business records exception (FRE 803(6)) to the hearsay rule of the Federal Rules of Evidence. In addition, the SIC Report is relevant and probative on the issue of Andersen's reckless conduct relating to its audit of WorldCom's financial statements. The fact that the SIC Report concludes that Andersen's audits were inadequate and that it had notice of potential accounting irregularities does not demonstrate "unfair" prejudice at all, and certainly not any that outweighs the probative value of the report. Accordingly, Andersen's motion to exclude the SIC Report from evidence at trial should be denied.

POINT I

THE SIC REPORT FALLS WITHIN THE BUSINESS RECORDS EXCEPTION

FRE 803(6) provides for the admission of business records created in the regular course of business activities. More specifically, FRE 803(6) states, in pertinent part:

[M]emorandum, report, record or data compilation, in any form, of acts, events, conditions, opinions or diagnoses, made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record, or data compilation, all as shown by the testimony of the custodian or other qualified witness... unless the source of information or the method or circumstances of preparation lack indicia of trustworthiness.

It is well settled in the Second Circuit that the "principal precondition to admission of documents as business records pursuant to Fed.R.Evid. 803(6) is that the records have sufficient indicia of trustworthiness to be considered reliable." *American Equities Group, Inc. v. Ahava Dairy Products Corp.*, 2004 WL 870260, No. 01 Civ. 5207, at *9 (April 23, 2004 S.D.N.Y.) (quoting *Potamkin Cadillac Corp. v. B.R.I. Coverage Corp.*, 38 F.3d 627, 632 (2nd Cir. 1994)); *In re:*

Blech Securities Litigation, 2003 WL 1610775, No. 94 Civ. 7696, at *5 (S.D.N.Y. Mar. 26, 2003) (key to determining the admissibility of a business record under Rule 803(6) is whether the document is trustworthy). Information is considered to be reliable and trustworthy where there is a business duty to report or verify the recorded information. *United States v. Reyes*, 157 F.3d 949, 952 (2d. Cir. 1998). Moreover, a business record is not deemed unreliable merely because it contains inaccuracies, ambiguities or errors. Instead, any doubts as to reliability due to such inaccuracies go to the weight of the evidence, and not its admissibility. *Id.* at 953. Accordingly, the Second Circuit has stated that FRE 803(6) “favors the admission of evidence rather than the exclusion if it has any probative value at all.” *United States v. Williams*, 205 F.3d 23, 34 (2d Cir. 2000). It is within the district court’s discretion to admit evidence pursuant to FRE 803(6) and the court’s decision will only be reviewed for abuse of discretion. *Reyes*, 157 F.3d at 951.

(a) The SIC Report Is A Business Record

The SIC Report is a business record because it was created and maintained in the ordinary course of WorldCom’s business – in particular, the business of the Board’s Special Investigative Committee -- even though it arose out of extraordinary circumstances. WorldCom, through its internal audit department, regularly reviewed and analyzed its business activities and operations in order to determine how it could function more effectively and efficiently. *See, e.g.*, Ex. D (SIC Report at 23, 119, 275, and 287). Andersen is well aware that WorldCom routinely engaged in such business reviews. In fact, Andersen specifically stated in its work papers that the purpose of WorldCom’s internal audit department was not to review financial statements but, rather, to conduct business operations audits to determine how the company could function more

effectively. *See, e.g.*, Ex. E (Dick Ex. 8, “Considering the Work of Internal Audit”, AA 019936-019938 at 019937).

The Committee’s investigation is essentially an extension of WorldCom’s practice to regularly review its business operations. The Report was filed by WorldCom with the SEC. *See* Ex. D (June 9, 2003 Form 8-K). It was generated pursuant to a WorldCom Board directive that it be an objective report, and it was based on underlying WorldCom documents, supplemented by over one hundred interviews, and thereafter filed with the SEC. Accordingly, as more fully explained below, the SIC Report is a WorldCom business record.

(b) The SIC Report Is Trustworthy Within The Meaning of FRE 803(6)

Andersen contends that the SIC Report is not trustworthy because it was prepared in anticipation of litigation and is incomplete. Both assertions are spurious as they are based on a mischaracterization of the nature and purpose of the report, and are belied by explicit statements, to the contrary, and the detailed findings and conclusions set forth in the report.

(i) The SIC Report Was Not Created In Anticipation Of Litigation

Andersen’s memorandum is devoid of any basis, much less fact or reference, for its assertion that the SIC Report was prepared in anticipation of litigation. Indeed, Andersen’s conclusion is wrong and ignores statements to the contrary in the SIC Report. The report states that it was not created in anticipation of litigation but, instead, for the purpose of detailing the accounting fraud and why it happened. The report states that the Committee was charged with conducting “a full and independent investigation of the accounting irregularities that gave rise to the announced intention to restate.” Ex D (SIC Report at 2). The report further states that the purpose of the investigation was to conduct an “independent review of what went wrong” in order to develop policies to prevent such accounting fraud from occurring again in the future. *Id.*

at 37. Consistent with the statements contained in the SIC Report, WCP also represented to the Bankruptcy Court that it was engaged to assist in the preparation of an “in-depth and unbiased report.” *See* Ex. G (McLucas Declaration at ¶ E). Nor was the report drafted with an eye towards WorldCom avoiding liability for the accounting fraud. *Id.* Under these circumstances, the SIC Report was not, and cannot be characterized as having been, prepared in anticipation of litigation.

(ii) The WorldCom SIC Report Is Not Incomplete

Andersen’s assertion that the WorldCom SIC Report is not trustworthy because it is incomplete for various reasons is equally without merit. Andersen’s assertion that the report concedes that “it is incomplete and based on questionable resources” takes a number of statements completely out of context. For example, Andersen’s statement that “[t]he Report concedes that ‘[t]here are questions relating to WorldCom that our investigation has not addressed,’ and that ‘in many cases our information is incomplete,’” *see* Andersen Br. At 12, creates the false impression. These statements are in a section of the report that explains that the subject matters of those issues would be addressed by the Bankruptcy Examiner. In fact, the Committee worked in conjunction with the Bankruptcy Examiner in order “to minimize duplication of efforts between the two investigations.” Ex. D (SIC Report at 3-4). Accordingly, the Committee focused its investigation on the accounting irregularities while the Bankruptcy Examiner focused on other issues. *Id.* The further statement cited by Andersen that “in many cases our information is incomplete” is also taken out of context. The full context of that statement is that the Committee was not able to interview the Andersen auditors -- because Andersen refused to make them available to the Committee (*id.* at 42) -- as well as a number of other individuals, including Ebbers, Sullivan and Myers. *Id.* at 3. Thus, the report stated “[a]s a

result, in many cases our information is incomplete and in particular, we do not know the full extent to which Ebbers or Sullivan directed or knew of actions we attribute to others.” *Id.* That, however, is hardly a basis to label the SIC Report as “incomplete” or not trustworthy.

Indeed, the SIC Report explains that practical limitations did not impede the Committee’s ability to conduct its investigation, nor preclude it from obtaining sufficient evidence to form a “reasonable foundation” on which to base its conclusions. *Id.* at 43. The Committee interviewed over 100 witnesses and reviewed millions of pages of documents relating to the accounting fraud. Moreover, as experienced and able legal counsel, WCP was prepared to deal with the prospect that “some of the people interviewed may have been motivated to describe events in a manner colored by self-interest or hindsight.” *Id.* WCP responded to this issue by making “every effort to maintain objectivity” and “[w]hen appropriate, [sic], used cross-examination techniques to test the credibility of witnesses.” *Id.* The mere fact that some witnesses may have been motivated to provide incomplete or misleading information to the Committee does not make the report untrustworthy. *Reyes*, 157 F.3d at 953. Consequently, the Committee was able to sufficiently deal with all issues that could limit its ability to find the truth stating: “[w]ithin these inherent limitations, we believe that our investigation was both careful and impartial, and the evidence developed is a reasonable foundation on which to base” its “judgments.” Ex. D (SIC Report at 43).⁴

POINT II

THE REPORT IS NOT SUBSTANTIALLY MORE

⁴ The SIC Report notes that Andersen refused to cooperate with the Committee by not permitting its personnel to be interviewed and failing to provide any documents to the Committee. *Id.* at 42. On this basis, in part, Andersen contends that the SIC Report is incomplete and should be barred as evidence. The Court should not countenance such tactics. But even if the Court considers the argument, the SIC Report is not incomplete as to Andersen because the Committee, and its accounting advisor PWC, had more than sufficient information to assess Andersen’s role. In fact, the Committee obtained and reviewed all of Andersen’s work papers from 1999-2002 and some of the desk files during the period. *Id.* at 223 n. 74.

PREJUDICIAL THAN PROBATIVE

FRE 403 permits a court to exclude relevant evidence only if its probative value is substantially outweighed by the risk of unfair prejudice or jury confusion. *George v. Celotex Corp.*, 914 F.2d 26, 30-31 (2d Cir. 1990). In order to demonstrate that the probative value is substantially outweighed by the risk of unfair prejudice, the moving party must show that the evidence “involves some adverse effect ... beyond tending to prove the fact or issue” for which it is being admitted. *Media Sport & Arts v. Kinney Shoe Corporation*, 1999 WL 946354, No. 95 Civ. 3901, at *7 (S.D.N.Y. Oct. 1999), quoting *United States v. Gelzer*, 50 F.3d 1133, 139 (2d Cir. 1995). The court should therefore only “exclude such evidence if it has “an undue tendency to suggest decision on an improper basis, commonly, though not necessarily, an emotional one.”” *Id.* quoting FRE 403 Advs. Comm. Notes. Finally, the Second Circuit has held that “[b]ecause Rule 403 permits the exclusion of probative evidence, it is an extraordinary remedy that must be used sparingly.” *George*, 914 F.3d at 31.

Here, Andersen has not demonstrated that the probative value of the SIC Report is substantially outweighed by the danger of unfair prejudice. Andersen’s main contention, that the SIC Report has the appearance of being a quasi-government document because of William McLucas’ former position within the government, is pure speculation and does not amount to unfair prejudice. *Cf. BD v. DeBuono*, 193 F.R.D. 117, 130-32 (S.D.N.Y. 2000) (rejecting argument that certain exhibits, which were either county records or prepared from county records, should be excluded from evidence because these exhibits carried an “aura of respectability”). There is nothing about the SIC Report that indicates or implies that it has quasi-governmental status. First, the SIC Report itself states it is the result of an investigation conducted by a special committee of the WorldCom Board of Directors. Second, Mr. McLucas’

name does not even appear on the face of the SIC Report, and only appears in a footnote in the body of the report concerning his affidavit that was submitted to the Bankruptcy Court. *See Ex. D* (SIC Report at 40 n.11). Rather, the authors of the SIC Report are listed as: Dennis R. Beresford, Nicholas de B. Katzenbach, and C.B. Rogers, Jr., three members of WorldCom's Board of Directors. Finally, there is absolutely no basis for Andersen's statement that it "is almost a certainty that the jury will 'Google'" Mr. McLucas and learn that he formerly held a position in the government. Andersen Br. at 22. Not only would that violate an instruction given to all juries in this District (*i.e.*, not to conduct any investigation yourself into the matters at issue in this case), but it is not even a certainty that Mr. McLucas' name will be mentioned at trial, much less that jurors will independently seek to learn more about him. Nevertheless, any risk that the jury may infer that the SIC Report is a quasi-governmental document can be cured by a proposed limiting instruction for submission to the jury. *Media Sports & Arts*, 1999 WL 946354 at *7.

Contrary to Andersen's argument, it well could be that Lead Plaintiff would be prejudiced by jury confusion if the SIC Report is not admitted into evidence. Evidence is going to be submitted to the jury that will indicate that the Committee was formed and conducted an investigation. If the SIC Report is excluded from evidence, the jury will be left to ponder if the Committee was able to determine what happened with respect to the accounting fraud and why it occurred. It may even leave the jury with the false impression that the investigation was not completed or that its conclusions were unfavorable to the Plaintiffs' case. Under such circumstances, the jury may question not only how Lead Plaintiff could find this information if WorldCom's own Committee could not, but also why Lead Plaintiff did not introduce the report.

In short, introduction of the SIC Report does not raise the specter of undue prejudice that substantially outweighs the probative value of the Report.

CONCLUSION

For the reasons stated above, Lead Plaintiff respectfully requests that the Court deny Andersen's motion *in limine* to exclude from evidence the SIC Report.

Dated: January 21, 2005

Respectfully submitted,

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