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: All Actions	:	

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 OPPOSITION TO MOTIONS TO DISMISS THE CLASS ACTION COMPLAINT BROUGHT BY DEFENDANTS ANDERSEN UK, MARK SCHOPPET AND ANDERSEN WORLDWIDE SC

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MISCELLANEOUS

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"), respectfully submits this memorandum of law in opposition to the motions to dismiss filed by Defendants Andersen UK ("Andersen UK"), Mark Schoppet ("Schoppet") and Andersen Worldwide Societe Cooperative ("Andersen Worldwide"). In responding to these motions, the NYSCRF will, as appropriate, refer to the NYSCRF's Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Class Action Complaint, dated January 24, 2003 ("NYSCRF's Jan. Br."), in response to motions to dismiss filed by other Defendants, including Arthur Andersen LLP ("Andersen") and Melvin Dick ("Dick"), and shall utilize the same defined terms as in its prior memorandum of law.

PRELIMINARY STATEMENT

Following in the footsteps of their affiliates Andersen and Dick, Andersen UK, Schoppet and Andersen Worldwide challenge the Section 10(b) claim against them (Count VIII) by alleging that – despite the undisputed magnitude of the WorldCom fraud – they have no responsibility for Andersen's fraudulent misstatements during the Class Period. Incredibly, the Andersen Defendants ask this Court to hold, as a matter of law, that in the largest accounting fraud in U.S. history, neither the accounting firms who conducted the audits, nor the senior partners who were in charge of those audits, are within reach of aggrieved investors. This position ignores a bevy of incontrovertible facts: (a) that the Andersen Defendants' audits missed approximately $11 billion in made-up earnings during the Class Period; (2) that Andersen and Andersen UK were put on notice in April 2000 that WorldCom was accounting fraudulently for its primary operating expense; and (3) that the Andersen Defendants turned a blind eye to numerous

"red flags" created by WorldCom's violations of generally accepted accounting principles ("GAAP"). Specifically, Andersen UK, Schoppet and Andersen Worldwide move to dismiss Count VIII on three primary grounds: (1) they themselves did not make any public statements; (2) the Complaint fails to allege their knowing or reckless misconduct with respect to Andersen's audit statements; and (3) this Court lacks personal jurisdiction over Andersen UK and Andersen Worldwide. These arguments are without merit and should be rejected.

First, the fact that Andersen UK and Andersen Worldwide did not sign the Andersen audit statements is inapposite. As detailed below, Andersen UK was responsible for auditing WorldCom's financial statements along with Andersen; Andersen Worldwide participated in the WorldCom audits; and Andersen UK personnel knew of improprieties within WorldCom that rendered the Company's financial statements – and thus Andersen's audit reports – materially false and misleading.

The fact that Schoppet did not sign, in his own name, Andersen's audit statements is similarly irrelevant. Schoppet served as Andersen's audit partner at least for the 2000 audit and, as such, was charged with the responsibilities of planning the audit (along with other Andersen partners and employees), overseeing the audit, and determining whether Andersen would issue a "clean" audit statement. His position as the head of the audit team, and intimate involvement with and responsibility for the audit reports issued by Andersen – which Andersen and Schoppet knew would be reproduced in WorldCom's annual reports and registration statements and, therefore, would be relied upon by current and potential investors in WorldCom – make Schoppet liable for those statements notwithstanding that they were signed by "Arthur Andersen LLP" – a partnership that could act only through its partners.

Second, contrary to Defendants' arguments, the Complaint adequately alleges the knowledge or reckless disregard on the part of all of the moving Andersen Defendants concerning the material misstatements in WorldCom's financial statements and Andersen's audit statements. In addition to the many "red flags" cited in the Complaint that were or should have been evident to Andersen (and, certainly, to its two identified WorldCom audit partners, Schoppet and Dick), there is also direct evidence of Andersen UK's knowledge of a post-reporting period, unsupported journal entry made at the direction of WorldCom's CFO – without support or justification in the accounting literature – which had the effect of causing WorldCom's financial statements to be false and misleading. Indeed, the Brabbs e-mail that Andersen UK and other Andersen Defendants miscast for purposes of their motions (which is attached as Exhibit 4 to the Declaration of Derek J. T. Adler, submitted in support of Andersen UK's motion to dismiss) explicitly states that in April 2000 – when Brabbs was WorldCom's Director of International Finance and Control, and Schoppet was Andersen's audit partner – Brabbs "reviewed at a high level … with the [Andersen] UK audit partner and senior manager" a post-closing period journal entry that had the effect of reducing WorldCom's reported line costs[1] [the precise misconduct that would later result in a reported $3.8 billion of overstatements in WorldCom's financial statements] and explained that this was an entry made in the US, for which he had been given "no support or explanation" and that the auditors should "request follow through in the US to ensure appropriate accounting was in place at the global consolidated level." ¶ 96. The Brabbs e-mail further states that

[1] Line costs are the fees that WorldCom pays local telephone companies to carry the calls of WorldCom's customers. ¶ 88. (All references to "¶__" shall be to paragraphs in the Complaint.)

what WorldCom decided to do was to "create a 'management company' (NOT a legal entity) and post it there." Id. (capitalization in original). According to Brabbs, this "had the effect of maintaining the management accounting reported figures, but I was making it clear that I did not see it as a journal [sic] that I could support from a legal or US or local accounting perspective." Id. (emphasis added). The e-mail continues: "This entry was made on 10 July 2000. The narrative reads 'late adj as instructed by Scott Sullivan'. It remains there today." Id. (emphasis added).

Contrary to the benign inferences that Andersen UK asks the Court to draw from the Brabbs e-mail, this document provides concrete evidence that: (1) Andersen UK was directly involved in the corporate auditing work for WorldCom; and (2) Andersen UK had actual knowledge of the unsupported, post-closing journal entry placed on WorldCom's books on July 10, 2000, where it remained even after the disclosures of June 25, 2002. Indeed, the manner in which Brabbs begins his e-mails makes clear that the unsupported journal entry, which had the impact of understating WorldCom's line costs, was "directly related in nature to the accounting irregularities" that would not come to investors' attention until two years later.

Third, there is no basis to dismiss Andersen UK and Andersen Worldwide for lack of personal jurisdiction. Andersen Worldwide is composed of partners from each of its affiliated entities, including Andersen and Andersen UK. As such, it is liable for the misconduct of its partners, including those whose activities occur in the United States. Andersen UK not only provided services in connection with Andersen's WorldCom audits, but it also had direct knowledge of the improprieties noted above – a critical aspect of WorldCom's multi-billion overstatement of earnings during the years when Andersen, with Andersen UK's assistance, audited the financial statements. Based on

their involvement in the WorldCom fraud, Andersen UK and Andersen Worldwide have more than the requisite minimum contacts with the United States and, under these circumstances, it would not contravene due process concerns by requiring Andersen UK and Andersen Worldwide to answer the claims asserted against them in this Court.

STATEMENT OF FACTS[2]

Between early 1999 and June 2002, WorldCom overstated its publicly reported earnings by an almost incomprehensible $9 billion. ¶ 5.[3] The accounting fraud, by far the largest in history, plunged the Company into bankruptcy, catapulted public outrage over duplicity within corporate America to heights never before seen, and resulted in numerous investigations, Congressional inquiries and, ultimately, the most extensive overhaul of the nation's securities laws since enactment of the Securities Exchange Act of 1934. ¶¶ 1, 7, 8, 105, 253, 295.

As alleged in the Complaint, and summarized in the NYSCRF's January Brief, what is as notable as the magnitude of the fraud is that it was accomplished through accounting gimmicks that were simple to perpetrate and, had the gatekeepers on whom the investing public relied not looked away, just as simple to uncover. Essentially, some

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[2] The Statement of Facts presented here includes facts that are of particular relevance to defendants Andersen UK, Schoppet and Andersen Worldwide. Lead Plaintiff respectfully refers the Court to, and incorporates by reference, the NYSCRF's Jan. Br. at 9-26, for a comprehensive statement of facts with respect to the entirety of the Complaint.

[3] As WorldCom has admitted, the Company overstated its pretax earnings by at least $209 million in 1999; $3.257 billion in 2000; $3.382 billion in 2001; and $835 million in the first quarter of 2002. ¶ 322. As of October 2002, when the Complaint was filed, there were reports that an additional $2 billion in restatements may be forthcoming. ¶ 5. WorldCom has since indicated that restatements will total approximately $11 billion for the years 1999-2002. See Susan Pulliam and Rebecca Blumenstein, WorldCom Audit Fraud May Rise to $11 Billion, Wall St. J., Apr. 1, 2003. As of this date, the Company has still not filed restated financials.

of WorldCom's most senior officers, including its CFO Scott Sullivan and Controller David Myers, met at the end of each quarter, compared the Company's actual financial results with the consensus estimates of Wall Street analysts and, when they determined that the actual results missed those estimates (usually by a wide margin), employed naked accounting chicanery to erase hundreds of millions of dollars of expenses, thereby engineering phony profits and ensuring that the Company would report "results" which met expectations. ¶¶ 3, 89-95, 98-101. The mechanics of the fraud were so rudimentary that a KPMG audit partner who later reviewed the accounting manipulations at WorldCom concluded that this was "an open and shut case;" another accounting expert stated that "[t]his is basic stuff." ¶¶ 94, 318.

The admitted accounting manipulations were accomplished in two primary ways. First, WorldCom inflated reported income by drawing on reserves that had supposedly been established to cover "merger-related" costs. ¶ 84. WorldCom's senior management instructed employees to make unsupported journal entries in the Company's general ledger that credited, or reduced, the Company's line cost expenses by an amount necessary to meet estimates. ¶¶ 3, 90. These instructions were made at the end of the quarter, after WorldCom's books for the quarter had closed, when WorldCom knew the precise amount by which its earnings would miss Wall Street estimates. ¶ 3. And, to make these entries balance on WorldCom's general ledger, the Company's CFO, Sullivan, ordered that various reserve accounts be debited in amounts equivalent to the line cost credits. ¶ 91(c). Significantly, there was no documentation to support these massive "adjustments," and no legitimate business rationale for them. ¶ 3. Through these fraudulent acts, WorldCom's management improperly inflated its earnings by $1.235

billion during the third and fourth quarters of 2000 alone – when Schoppet served as Andersen's audit partner. ¶ 93.

Second, WorldCom's senior management instructed WorldCom employees to fraudulently account for line cost expenses as capital expenditures. ¶ 95(c). Again, these accounting adjustments were made without any supporting documentation or legitimate business rationale. ¶ 3. As a result, during 2001 and the first quarter of 2002, WorldCom treated a substantial portion of its line cost expenses as "capital investments," and recorded them as an asset on the Company's balance sheet, where they would be depreciated over time, rather than being recorded as expenses, which would have had a huge and immediate adverse impact on WorldCom's reported profits. ¶ 94. This was a bold violation of generally accepted accounting principles ("GAAP"), which specifically provide that line costs are to be accounted for as expenses, and cannot be capitalized. Id. Indeed, prior to 2000, WorldCom had always accounted for line costs – which as the Andersen Defendants surely knew, constituted its single biggest operating expense – as an expense, and had reported line costs as a separate line item on its income statements as part of its operating expenses. ¶ 88. Through these fraudulent acts, WorldCom improperly inflated its reported income from 2001 through the first quarter of 2002 by a staggering $3.8 billion. ¶ 3.

On June 25, 2002, WorldCom issued a press release announcing that an internal audit had discovered approximately $3.8 billion of improperly reported earnings for 2001 and the first quarter of 2002 and that it would restate its financial statements for this time period. ¶ 104. On July 8, 2002, Andersen audit partner Dick was among those summoned to testify before the House Committee on Financial Services; in front of an incredulous Congressional committee, he testified that Andersen could not have

discovered the fraud. ¶ 106. Two weeks later, WorldCom filed the largest bankruptcy in history. ¶ 6.

As was subsequently disclosed, the fraud began long before the third quarter of 2000. Internal WorldCom e-mails show that WorldCom senior management was "cooking the books" by improperly recording line cost expenses by no later than the first quarter of 2000. ¶ 96. Moreover, while the final restatement has not been announced, the Company has since admitted that its earnings for 1999 were materially overstated by hundreds of millions of dollars, and that as a result the Company will be required to restate its results for 1999 in addition to those for 2000, 2001 and the first quarter of 2002.

One of the key features of the fraud involved intentional understatements of line cost expenses. As noted above, in April 2000 – two years before the fraud was disclosed and before some $17 billion in WorldCom bonds were sold to the unsuspecting public – Steven Brabbs, then WorldCom's Director of International Finance and Control, alerted high ranking Andersen UK personnel that, after the books for the International Division had closed for the first quarter of 2000, an entry had been made on the books that reduced the International Division's line cost expenses by $33.6 million. ¶ 96(a). When Brabbs questioned the entry, he discovered that Sullivan had directed the entry be made, but Brabbs never received any justification for this accounting treatment. Id. Brabbs reviewed his division's first quarter results and the questionable transfer in a "high level" meeting with an Andersen UK partner and senior manager. ¶ 96(b). Brabbs told the Andersen UK partner and senior manager that the increase in margin trend as a result of the fraudulent transfer was "obvious" and urged them to consult with Andersen in the United States. Id. The entry was never corrected. To the contrary, as was disclosed to

Andersen and Andersen UK, WorldCom established a fictitious entity and placed the costs on the books of that sham entity, where it remained until the fraud was disclosed more than two years later. ¶ 96(d).

Despite having actual knowledge that WorldCom's management was fraudulently – or, at the very least, suspiciously – underreporting line cost expenses, none of the Andersen Defendants ever investigated WorldCom's practices of accounting for these line costs or corrected the accounting treatment. ¶¶ 96, 317. Indeed, these phony journal entries remained on WorldCom's books until after Andersen was replaced as WorldCom's auditor in May 2002. ¶ 317.

Although Andersen UK and Andersen Worldwide go to great lengths to try to distance themselves from their affiliate Andersen, the Complaint amply alleges that these entities operated as a single, international organization in conducting the WorldCom audits. ¶¶ 41-42. Indeed, Andersen UK has conceded that it played an integral role in the WorldCom audits by submitting an affidavit in connection with its motion to dismiss; that affidavit even details how it provided opinions on WorldCom's financial statements and performed work at the direction of its affiliate, Andersen. See Affidavit of Peter Ridley in Support of Defendant Arthur Andersen UK's Motion to Dismiss the Complaint ("Ridley Aff.") ¶ 6. As detailed in the Complaint, the Brabbs e-mail is further evidence that Andersen and Andersen UK operated as one organization in auditing WorldCom's financial statements. ¶ 96. Similarly, the Complaint details how Andersen Worldwide operated as the international umbrella organization for its members. ¶ 42. Through its affiliates, Andersen Worldwide was involved in the WorldCom audits. Id.

ARGUMENT[4]

I. THE COMPLAINT STATES CLAIMS UNDER SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5

Count VIII of the Complaint adequately alleges §10(b) claims against Andersen UK, Schoppet and Andersen Worldwide. [5]

A. The § 10(b) Claim Against Andersen UK Must Be Sustained

Andersen UK does not dispute that it was responsible for auditing WorldCom's financial statements along with Andersen; indeed, as discussed below, one of the affidavits accompanying its motion to dismiss expressly admits that Andersen UK participated in the WorldCom audits. Nor does Andersen UK deny that it had actual notice of fraud at the Company in April 2000 – before WorldCom offered nearly $17 billion of debt securities to the investing public pursuant to registration statements which certified that the financial statements therein had been audited in compliance with generally accepted auditing standards ("GAAS") and fairly presented the financial condition of WorldCom in all material respects. Rather, Andersen UK's motion offers two basic arguments: (1) because it did not sign the indisputably false and misleading audit reports in this case it cannot be held liable under §10(b) as a matter of law; and (2) it did not act with scienter. Andersen UK Br. at 6, 9.[6] As set forth below, each of these arguments fails.

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[4] Lead Plaintiff respectfully refers the Court to, and incorporates by reference, the NYSCRF's Jan. Br. at 9 n.5 and 26-27 for the legal standard governing a Rule 12(b)(6) motion to dismiss.

[5] Lead Plaintiff respectfully refers the Court to, and incorporates by reference, the NYSCRF's Jan. Br. at 47-50 for the legal standard governing a claim under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

[6] References to "Andersen UK Br." are to the Memorandum of Law of Defendant Andersen UK in Support of Motion to Dismiss the Claim Against It, dated April 11,

1. The Complaint Adequately Alleges That Andersen UK Made Materially False and Misleading Statements

Andersen UK argues that it did not make any materially false or misleading statements, while simultaneously admitting to the Court – through an affidavit from one of its partners – that it was directly involved with WorldCom and with Andersen's audits of the Company. See Ridley Aff. ¶ 6.[7] The affidavit reveals that Andersen UK performed "two general functions with respect to certain UK subsidiaries of WorldCom, Inc." Id. First, Andersen UK served as the statutory auditors for subsidiaries of WorldCom and, in connection with that role, was responsible "for providing opinions, under UK auditing standards, on the financial statements." Id. Second, Andersen UK performed work at the direction of Andersen "in furtherance of Arthur Andersen LLP's US work for WorldCom, Inc." Id. Andersen UK further admits that it had a "contractual relationship with Andersen Worldwide Societe Cooperative ('AWSC'), pursuant to which it cooperated with Arthur Andersen LLP and other independent member firms in the provision of professional services within their respective jurisdictions." Id. at ¶ 3. Thus,

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2003. References to "Schoppet Br." are to the Memorandum of Law in Support of Mark Schoppet's Motion to Dismiss, dated April 11, 2003. References to "Andersen Worldwide Br." are to the Memorandum of Law of Defendant Andersen Worldwide Societe Cooperative in Support of Its Motion to Dismiss the Complaint, dated January 31, 2003.

[7] By submitting an affidavit in support of its attack on the sufficiency of the Complaint, Andersen UK has attempted to convert its motion to dismiss into a motion for summary judgment pursuant to Fed. R. Civ. P. 56. See Chambers v. Time Warner, Inc., 282 F.3d 147, 153 (2d Cir. 2002). Lead Plaintiff objects to conversion at this time, given that it has not yet been permitted to obtain any discovery from Andersen UK. See Jordan (Berm.) Inv. Co., Ltd. v. Hunter Green Inves. Ltd., 154 F. Supp. 2d 682, 689 (S.D.N.Y. 2001) ("[A] trial court should not transform a 12(b)(6) motion into a summary judgment motion where, as here, the motion has been filed in lieu of an answer, and the parties have neither completed discovery nor formally requested that the motion be converted."); Fed. R. Civ. P. 12(b)(6) ("all parties shall be given reasonable opportunity to present all

as alleged in the Complaint (¶ 41), and now admitted by Andersen UK (Ridley Aff. ¶ 6), Andersen UK was directly involved with the auditing of WorldCom's financial statements and the issuance of Andersen's audit opinions and, accordingly, can be held liable for the false and misleading statements contained therein.

Contrary to what Andersen UK contends, it should not be absolved from liability because it was an affiliated Andersen entity that signed the audit reports at issue. In re Lernout & Hauspie Securities Litigation, 230 F. Supp. 2d 152 (D. Mass. 2002), which also involved a massive accounting fraud, is directly on point. In that case, plaintiffs alleged that KPMG UK and KPMG US were liable for knowingly or recklessly issuing false and misleading audit reports, even though the reports were actually signed by KPMG Belgium. Precisely as Andersen UK does here, KPMG UK and KPMG US argued that, because they did not sign the audit reports, they could not be held liable under § 10(b). The Court emphatically rejected that argument, holding that primary liability under § 10(b) was consistent with the holding of Central Bank of Denver v. First Interstate Bank of Denver, 511 US 164 (1994), because these related KPMG entities were involved in conducting the audit and knew that the audit opinions would be publicly disseminated. As the Court held:

> Absolving an auditor who prepares, edits and drafts a fraudulent financial statement knowing it will be publicly disseminated simply because an affiliated auditor with which it is working under a common trademark is the one to actually sign it, would stretch *Central Bank's* holding too far. Under the best reading of Central Bank and its progeny, KPMG UK's role in the making of the 1998 Annual Report was sufficient to trigger primary liability if it also acted with the requisite level of scienter.

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material made pertinent") (emphasis added). By citing to the Ridley Affidavit, the NYSCRF does not intend to waive its objection.

Id. at 168-69 (emphasis added).[8]

Andersen UK's reliance upon Wright v. Ernst & Young LLP, 152 F.3d 169 (2d Cir. 1998) and Shapiro v. Cantor, 123 F.3d 717 (2d Cir. 1997) is misplaced because, among other things, those decisions were premised upon express disclaimers which put the public on notice that the alleged misrepresentations were not the auditor's statements.

In Wright, the Second Circuit's articulation of the issue before it is sufficient to distinguish the instant action:

> The question we must answer is whether, under the [Exchange] Act, persons who purchase stock in a company that issued a press release containing false and misleading financial information, with a notation that the information is unaudited and without mention of its outside auditor, can recover from the auditor for its private approval of the information contained in the press release.

152 F.3d at 171 (emphasis added). The Court rejected plaintiffs' argument that it had pled primary liability under § 10(b), holding that the press release did not contain any statement by the auditors and that the explicit disclaimer of auditor responsibility (i.e., "unaudited") precluded the possibility of reliance by investors. Wright, 152 F.3d at 175-76. Significantly, the Court emphasized that "Ernst & Young's assurances were never communicated to the public either directly or indirectly. BT issued the press release without a whisper of Ernst & Young's involvement." Id. at 176 (emphasis added).

In Shapiro, the complaint alleged that Touche Ross "participated in the defendants' fraudulent scheme by providing accounting, auditing and financial analysis" for three private placement memoranda, including the preparation of financial exhibits

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[8] In Lernout & Hauspie, the Court denied KPMG US's motion to dismiss and granted KPMG UK's motion to dismiss – but only after finding that that complaint did not allege scienter with sufficient particularity. Id. at 169. By contrast, the particularized facts alleged in this case satisfy the requirements for pleading Andersen UK's scienter. See Section I.A.2, infra.

that were attached as exhibits to the offering memoranda. 123 F.3d at 719. The Second Circuit affirmed the dismissal of the complaint (which was filed four years before the Supreme Court's decision in Central Bank), adopting the district court's reasoning that Touche Ross "did not issue an opinion or certification as to the prospectus," and that "[a]ttached to each of the projections that Touche Ross issued was a letter which stated that the projection was based on management's 'knowledge and belief' and cautioned that the projection 'does not include an evaluation of the support for the assumption underlying the projection.'" Id. (emphasis added). In rejecting plaintiffs' § 10(b) claim, the Court of Appeals held that Touche Ross' only role in the purported fraud was in providing financial projections (which were not alleged to contain a false or misleading statement) which were included in the offering memoranda, and that the firm had no obligation to disclose any information unrelated to the financial projections. 123 F.3d at 721-22. Absent allegations of a fraudulent misstatement or a duty to disclose, the court held that "[p]laintiffs' argument is best summarized in its statement that the Touche Ross defendants were in complicity throughout with the principal defendants. This assertion of aiding and abetting does not support a claim under § 10(b) as interpreted by the Central Bank Court." Id. at 721.

In sharp contrast to Wright and Shapiro, the Complaint alleges (and Andersen UK admits in paragraph six of the Ridley Affidavit) that Andersen UK was directly involved with the WorldCom audits, which contained fraudulent misstatements, and cites direct evidence of an improper post-closing journal entry, made without any support or justification, that was known to Andersen UK and had the effect of improperly reducing WorldCom's reported line cost expenses. ¶¶ 41, 96, 317. Moreover, Lead Plaintiff alleges – and the Ridley Affidavit confirms – that Andersen and Andersen UK, through

their common membership in the Andersen Worldwide partnership, "had a contractual relationship" through which Andersen and Andersen UK "cooperated … in the provision of professional services" for clients such as WorldCom. ¶ 42; Ridley Aff. ¶ 3.

Andersen UK further seeks to avoid responsibility for its direct involvement with WorldCom and the audits undertaken by Andersen and its affiliates by claiming: "The rule against collective pleading is particularly relevant to claims against auditing firms that have international affiliates. Indeed, this Court and others have consistently applied the rule to dismiss claims that seek to treat affiliated accounting firms – like Andersen US and Andersen UK – as if they were a single entity." Andersen UK Br. at 8. Yet, the bulk of the cases upon which Andersen UK relies (as does Andersen Worldwide, in making a similar argument) are factually distinguishable, and did not involve complaints that alleged specific participation and knowledge of wrongdoing on the part of the "international affiliates."[9]

Although Andersen UK relies upon this Court's decisions in In re Sotheby's Holdings, Inc., No. 00 Civ. 1041, 2000 WL 1234601 (S.D.N.Y. Aug. 31, 2000), and Cromer Fin., Ltd. v. Berger, 137 F. Supp. 2d 452 (S.D.N.Y. 2001) ("Cromer I"), these are also distinguishable from the present case. In Sotheby's Holdings, plaintiffs alleged only

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[9] In Lernout & Hauspie, plaintiffs argued, in part, that because KPMG UK and other members of KPMG International held themselves out as a single entity, each entity should be jointly and severally liable for the others' acts and statements. However, the court concluded that the only source cited by plaintiffs – the KPMG website – "belie[d] their claim," because the website stated that each entity was separate and independent. 230 F. Supp. 2d at 170. Similarly, in Bamberg v. SG Cowen, 236 F. Supp. 2d 79 (D. Mass. 2002), the statement upon which plaintiffs sought to rely contradicted their claims against a Singapore entity because it stated that the entity declined to give an unqualified audit opinion. In In re A.M. Int'l., Inc. Securities Litigation, plaintiffs sued various foreign affiliates of Price Waterhouse who allegedly acted "as a source of information." 606 F. Supp. 600, 607 (S.D.N.Y. 1985). Yet, the complaint supplied no support or examples of the allegation.

that one of the defendants was a holding and parent company of the subsidiary corporate defendant, and sought to hold the subsidiary liable for annual reports filed by and on behalf of the parent company. This Court noted that the plaintiffs' sole allegation was that there was a subsidiary/parent relationship between the entities and held that "absent additional allegations that any information transmitted to Sotheby's Holdings, Inc. [parent company] by Sotheby's Inc. [subsidiary] was itself false and misleading and that its source knew it to be such, plaintiffs would still fail to state a claim against Sotheby's, Inc." 2000 WL 1234601, at *6. Here, in contrast, the Complaint expressly pleads Andersen UK's knowledge of misstatements in WorldCom's financial statements. ¶¶ 96, 317.

In Cromer I, plaintiffs sought to hold the international defendant liable based solely on a document identifying the international defendant as an affiliate of the domestic corporate defendant. In the alternative, plaintiffs in Cromer I sought to hold the international entity liable by piercing the corporate veil. 137 F. Supp. 2d at 485 & n.23. This Court held that such generalized theories of liability, without any supporting facts of the international affiliate's involvement in the claimed misconduct, were insufficient to state a claim.[10]

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[10] Notably, on a motion to amend the complaint, this Court held that plaintiffs had sufficiently stated a claim against the international affiliate based on an agency theory of Section 10(b) liability. See Cromer Fin., Ltd. v. Berger, Nos. 00 Civ. 2284 and 00 Civ. 2498, 2002 WL 826847 (S.D.N.Y. May 2, 2002) ("Cromer II"). In the amended complaint, plaintiffs alleged that a partner of Deloitte & Touche (Bermuda), had the actual authority to act on behalf of Deloitte & Touche Tohmatsu ("Deloitte"), a Swiss Verein headquartered in New York. Plaintiffs further alleged, inter alia, that Deloitte was directly identified as responsible for the audits, the two companies joined in preparing and issuing the financial statements at issue, the Bermuda company (in its proposal) stated that it was part of Deloitte Touche Tohmatsu International, and the audit reports had the name and logo of Deloitte (which Deloitte required) with a Bermuda address. Based on these allegations, this Court held that the amended pleading was sufficient to

While Lead Plaintiff does not assert that Andersen UK signed the audit statements here, it does assert direct participation and knowledge on the part of Andersen UK, which placed Andersen UK within the ambit of persons who may be liable for the statements issued by Andersen under SEC v. First Jersey Securities, Inc., 101 F.3d 1450, 1471 (2d Cir. 1996) ("Primary liability [under Section 10(b)] may be imposed not only on persons who made fraudulent misrepresentations, but also on those who had knowledge of the fraud and assisted in its perpetration."). Moreover, as shown in Section I.D. infra, Andersen UK may also be liable under Section 10(b) and Rule 10b-5 based on its "scheme" liability, which does not require the making of false statements by or attributable to each defendant.

2. The Complaint Adequately Alleges Andersen UK's Scienter

Andersen UK's conduct constitutes "an egregious refusal to see the obvious, or to

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state a claim against Deloitte notwithstanding that the audit reports were signed "Deloitte & Touche." Id. at *5.

Other cases cited by Andersen UK and Andersen Worldwide are similarly inapposite. Jeffries v. Deloitte Touche Tohmatsu International, 893 F. Supp. 455 (E.D. Pa. 1995), aff'd, 91 F.3d 124 (3d Cir. 1996), is an employment discrimination case in which the plaintiff could not prove at the summary judgment stage that Deloitte Touche Tohmatsu Int'l was her actual employer. 893 F. Supp. at 456-57. Howard v. Klynveld Peat Marwick Goerdeler, 977 F. Supp. 654 (S.D.N.Y. 1997), aff'd, 173 F.3d 844 (2d Cir. 1999), merely held that "general public statements" suggesting an international network of firms alone were insufficient to justify a finding of partnership. 977 F. Supp. at 662. The court in Reingold v. Deloitte Haskins & Sells, 599 F. Supp. 1241 (S.D.N.Y. 1984), disregarded brochures and pamphlets that purported to link a foreign firm to a worldwide organization because they were contradicted by contracts before the court. 599 F. Supp. at 1253-54, n.10. And Young v. F.D.I.C., 103 F.3d 1180 (4th Cir. 1997), involved a plaintiff who sought to demonstrate that a Bahamas-based entity was an agent of a United States entity through South Carolina's Uniform Partnership Act ("UPA"), which requires a showing that one extended credit to a partnership based on a representation. Id. at 1192. However, the only evidence offered was a brochure that the plaintiff's attorney had picked up at a seminar, and the plaintiff thus failed to satisfy the reliance element of the UPA.

investigate the doubtful," which is sufficient to state a claim against Andersen UK. See SEC v. Price Waterhouse, 797 F. Supp. 1217, 1240 (S.D.N.Y. 1992). The Complaint adequately alleges Andersen UK's recklessness, if not actual knowledge, based on its awareness of red flags and virtually total abdication of its duty to investigate. The Brabbs information clearly put Andersen UK on notice of facts strongly suggesting something was very wrong with WorldCom's accounting: the fact that the improper accounting for line cost expenses was made by a journal entry after the International Division had closed its books for the first quarter of 2000; that Brabbs was given no support or explanation for the entry; that the journal entry had the direct consequence of increasing the International Division's margins at a time when they were declining; and that WorldCom's CFO was directing the improper accounting for line costs. ¶ 96(a). In reviewing the International Division's first quarter results with Andersen's audit partner in the United Kingdom, among others, Brabbs noted that the increase in margin trend was "obvious" and told Andersen that they should "request follow through in the United States to ensure appropriate accounting treatment was in place at the global consolidated level." ¶ 96(b). This was passed on to WorldCom executives in the United States and Andersen. Id.

The Brabbs e-mail shows that Andersen UK knew of falsifications contained in WorldCom's financial statements and, at most, merely informed others of it. ¶ 317. As a result, Andersen UK's argument that it should be absolved from liability based on a single paragraph in a report – Andersen UK Br. at 10 – is unpersuasive. The Complaint clearly alleges that Andersen UK took no actions to investigate or to ensure that the affiliate with which it was working, Andersen, conducted an investigation into the false journal entry. Id. Such allegations are sufficient to allege a viable Section 10(b) claim

against Andersen UK. Price Waterhouse, 797 F. Supp. at 1240; see also In re Health Mgt., Inc. Sec. Litig., 970 F. Supp. 192, 203 (E.D.N.Y. 1997) (allegation of auditors' failure to follow up on letter warning them of accounting improprieties sufficient to allege scienter); In re Ikon Office Solutions, Inc. Sec. Litig., 66 F. Supp. 2d 622, 629 (E.D. Pa. 1999) ("Ikon I") (same).[11]

Based on the foregoing, the Complaint adequately states a §10(b) claim against Andersen UK.[12]

B. The § 10(b) Claim Against Schoppet Must Be Sustained

Schoppet does not dispute that the largest accounting fraud in U.S. history occurred on Andersen's watch, or that he was the audit engagement partner responsible for audits of WorldCom's financial statements in 2000 and prior years. ¶ 43. Rather, Schoppet claims that (1) the Complaint fails to particularize any statement made by him; (2) the Complaint does not allege facts giving rise to a strong inference that he acted with scienter; and (3) the NYSCRF cannot rely on the "group pleading" doctrine. See Schoppet Br. at 1-2. Schoppet's attacks on the Complaint are unavailing.

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[11] Facts demonstrating a virtual abrogation of the duty to investigate, i.e., where the audit "amounted to no audit at all," are sufficient to allege recklessness. See In re Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d 314, 333 (S.D.N.Y. 2001). This may be shown by allegations that the auditors ignored red flags warning them of potential improper accounting practices. See id. at 334 (auditors aware of red flags supporting "the critical allegation that if Andersen were conducting any kind of audit at all, they would have seen the potential problems with the . . . receivables and the need to investigate further"); In re Oxford Health Plans Sec. Litig., 51 F. Supp. 2d 290, 295 (SDNY 1999) ("Oxford I").

[12] As shown above, Lead Plaintiff has in fact alleged misstatements and omissions attributable to Andersen UK. Thus, Andersen UK's arguments that Lead Plaintiff "ha[s] not identified any alleged misstatements attributable to Andersen UK," and "cannot have relied on any such misstatement or suffered any injury proximately caused by such reliance," should be rejected. See Andersen UK Br. at 9.

1. Schoppet Made Materially False and Misleading Statements

Schoppet's argument that the Complaint does not adequately allege that he made materially false and misleading statements requires little by way of response. WorldCom has admitted that its 1999, 2000, and 2001 reported pretax income – as set forth in its financial statements audited by Andersen – was overstated by nearly $11 billion, and Andersen has withdrawn at least one of its audit opinions, stating that it should no longer be relied upon. ¶ 104. GAAP only permits restatement of prior financial statements based upon information that existed at the time the financial statements were prepared. See APB Opinion No. 20 at ¶ 13; see also In re Telxon Corp. Sec. Litig., 133 F. Supp. 2d 1010, 1026 (N.D. Ohio 2000) (defendants had no basis to dispute that company's financial statements contained material misstatements because "[the company], itself, admitted its prior disclosures were materially misstated when it issued the restatements which gave rise to this litigation"). Thus, Schoppet cannot seriously deny that, at the time when he was the audit partner responsible for the WorldCom audits, WorldCom's financial statements were materially false when issued and, accordingly, that Andersen's audit opinions certifying that the financial statements were prepared in accordance with GAAP were likewise false.

Schoppet was Andersen's audit partner on its audit of WorldCom's 2000 financial statements at issue in this case. ¶ 43. As partner-in-charge of the 2000 audit, Schoppet may be presumed to have issued Andersen's audit opinion.[13] See In re Oxford Health

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[13] The Complaint sets forth in extensive detail the particular false statements made by Andersen, i.e., that WorldCom's 1999, 2000 and 2001 financial statements were presented in conformity with GAAP and that Andersen's audits were performed in accordance with GAAS (¶¶ 133-34, 156-57, 187-88), and also identifies where and when these false statements appeared, i.e., in the audit statements accompanying the financial statements appearing in, inter alia, WorldCom's 1999, 2000, and 2001 Form 10-Ks, and

Plans, Inc. Sec. Litig., 187 F.R.D. 133, 142 (S.D.N.Y. 1999) ("Oxford II") (corporate officers presumed to have issued false statements attributed to company under "group pleading" doctrine); SEC v. First Jersey Securities, 101 F.3d at 1471 (primary liability under Rule 10b-5 may be imposed "not only on persons who made fraudulent misrepresentations, but also on those who had knowledge of the fraud and assisted in its perpetration") (citations omitted); see also Central Bank at 191 ("Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5"); In re SmarTalk Teleservices, Inc. Sec. Litig., 124 F. Supp. 2d 527, 545 (S.D. Ohio 2000); In re Baan Co. Sec. Litig., 103 F. Supp. 2d 1, 17 (D.D.C. 2000); In re Health Mgt., Inc., Sec. Litig. 970 F. Supp. 192, 208-09 (E.D.N.Y. 1997). Moreover, as the engagement partner, Schoppet reviewed audit workpapers and either became aware of, or but for his recklessness would have become aware of, the numerous red flags available to Andersen in connection with its audits of WorldCom's financial statements – including, of course, the information conveyed by Brabbs in April 2000 to high level personnel at Andersen UK and thereafter transmitted to Andersen. ¶¶ 432-33. Thus, as the Andersen partner directly responsible for "Arthur Andersen LLP" being affixed to the firm's audit opinions, Schoppet can and should be held liable for issuing Andersen's audit opinions for 2000 and for the false and misleading statements made therein.[14]

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incorporated with Andersen's consent in the registration statements for the Offerings and the Intermedia acquisition. ¶¶ 133-34, 156-57, 185, 187-88, 199-200, 207-08, 220.

[14] In a similar setting, the SEC has just recently suspended two audit partners of Ernst & Young LLP, based on their individual roles in approving the "clean" opinion letters issued by E&Y for financial statements of Cendant Corporation ("Cendant") and

2. The Complaint Sufficiently Alleges That Schoppet Acted with Scienter

As set forth in extensive detail in the NYSCRF's January Brief at 73-81 (incorporated here by reference), Schoppet's employer Andersen was aware, or but for its recklessness would have become aware, of the numerous "red flags" available in connection with its audits of WorldCom's financial statements. Allegations of violations of GAAP and GAAS "may be one of several 'red flags' that support an inference of scienter." In re Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d 314, 334 (S.D.N.Y. 2001); see also Oxford I at 295; In re Health Mgt., Inc. Sec. Litig., 970 F. Supp. 192, 203 (E.D.N.Y. 1997); In re the Leslie Fay Cos., Inc. Sec. Litig., 871 F. Supp. 686, 699 (S.D.N.Y. 1995).

In this case, the unsupported and fraudulent adjustments to WorldCom's books would have been readily apparent had Schoppet bothered to direct his audit team to review WorldCom's general ledger. Indeed, over and above the unsupported post-closing journal entry that Brabbs brought to the attention of Andersen and Andersen UK in the spring of 2000, many of the transfers from reserve accounts to income and from expense accounts to capitalized costs were made by adjusting journal entries at the direction of senior management after the end of each fiscal quarter, without any supporting documentation. ¶ 432. The audacity of the fraud compelled the Chairman of

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its predecessor, CUC International, Inc. ("CUC"). See SEC Litigation Release No. 18102, "SEC To Suspend Two Auditors of Cendant Corporation and CUC International from Practicing before the Commission," April 24, 2003 (attached hereto as Tab A). While not charging the two individuals with knowledge of the fraudulent accounting, the SEC sanction was based on findings that the individuals failed to detect the fraud at Cendant and CUC, failed to obtain sufficient evidence to support the financial statements, and were aware of numerous practices indicating that the financial statements did not conform with GAAP.

WorldCom's Board of Directors to comment that Andersen's failure to uncover these accounting irregularities was "inconceivable." ¶ 318.

The Brabbs e-mail, by itself, is sufficient to establish Schoppet's scienter because it shows that Andersen had direct knowledge that WorldCom was fraudulently underreporting line cost expenses in early 2000 – the very type of fraud that was disclosed more than two years later. See, e.g., In re Health Mgt., 970 F. Supp. at 203 (allegation of auditors' failure to follow up on letter warning them of accounting improprieties sufficient to allege scienter); Ikon I, 66 F. Supp. 2d at 629 (allegations that auditors were directly informed that corporate CFO was "cooking the books" sufficient to state claim).[15] Had Schoppet followed up on Brabbs' warnings and attempted to see if there was any support for the post-first quarter 2000 journal entry, he would have learned that the entry was fictitious, contrary to GAAP, and part of a much larger pattern of fraudulent accounting throughout WorldCom that had started no later than 1999.

The Complaint also alleges Schoppet's clear motive and opportunity to participate in the fraud. WorldCom was the single most valuable client of Andersen's Jackson, Mississippi office. ¶ 435. Giving WorldCom a "clean" audit report in 2000 and prior years, when Schoppet was the audit partner, allowed Andersen to remain in a position to

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[15] The same court that denied Ernst & Young's motion to dismiss the complaint in Ikon I subsequently granted the accounting firm's motion for summary judgment after the completion of discovery. See In re Ikon Office Solutions, Inc. Sec. Litig., 131 F. Supp. 2d 680 (E.D. Pa. 2001), aff'd, 277 F.3d 658 (3d Cir. 2002). As the Third Circuit found, a formidable record had been developed, which demonstrated that Ernst & Young had conducted extensive audits, sufficiently investigated known red flags, and had not relied blindly on the company's internal audit controls. Ikon, 277 F.3d at 668-77. Here, the facts alleged in the Complaint, which must be taken as true, assert that the Andersen Defendants (including Schoppet) failed to investigate glaring red flags, and that WorldCom lacked sufficient internal audit controls. ¶¶ 317-21, 337-42, 432-33. Thus, the subsequent granting of summary judgment in Ikon is not relevant to the present motion.

obtain $16.8 million for services it provided to WorldCom in 2001. Id.[16] This substantial compensation provided a strong incentive to turn a blind eye to WorldCom's financial statement manipulations.[17] See Complete Mgt., 153 F. Supp. 2d at 335 ("[D]uring the class period Andersen was paid over $1 million for consulting work. . . . The complaint supports the inference that the desire to maintain the considerable revenues to Andersen's Healthcare Practice Group created incentives for the auditors to seek to please CMI's management at the expense of accuracy and/or completeness.").

For the foregoing reasons, Schoppet may be presumed to have been an integral part of Andersen's audits. As a result, the Complaint adequately alleges scienter on the

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[16] In the reply brief submitted by Andersen and Dick in support of their motions to dismiss, those defendants sought to minimize the distinction between auditing and non-auditing fees obtained by Andersen from its WorldCom relationship. However, as news of accounting fraud after accounting fraud has revealed, accounting firm partners have been highly motivated – just as investment bankers and research analysts have been highly motivated – to strain to please their corporate clients in order to obtain highly lucrative consulting work, in addition to the auditing work.

[17] In response to these allegations, Schoppet – like Andersen and Dick in their brief – relies on a line of cases that adopts the now plainly discredited hypothesis that an auditor has no motive to deliberately or recklessly overlook a client's fraud because it would be "irrational" for an auditor to put his or her professional reputation at risk to maintain a valuable client. See, e.g., DiLeo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir. 1990). The rash of recent accounting scandals at major United States corporations, and the role that outside accountants – in particular, Andersen – have played in those scandals have punctured this hypothesis. Indeed, the predicate for the passage of the Sarbanes-Oxley Act was a Congressional finding that "the issue of auditor independence is so fundamental to the problems currently being experienced in our financial markets that statutory standards are needed to assure the independence of the auditor from the audit client." S. Rep. No. 107-205, 107 Cong., 2d Sess., at 18 (2002). As noted in the NYSCRF's Jan. Br., at 80-81 & n.39, this hypothesis has never been reflected in the accounting literature, which, to the contrary, demonstrates a serious concern with the possibility that conflicts of interest may compromise an auditor's objectivity. As a result, the Court should not give credence to this argument.

part of Schoppet.[18]

C. The § 10(b) Claim Against Andersen Worldwide Must Be Sustained

Andersen Worldwide, like Andersen and the other Andersen Defendants, does not dispute that: (1) WorldCom's financial statements constituted materially false and misleading statements; and (2) Andersen issued numerous statements – which were false and misleading at the time they were made – certifying that WorldCom's financial statements were materially accurate and issued in accordance with GAAP. Nonetheless, Andersen Worldwide seeks to evade responsibility for Andersen's false and misleading statements by virtue of its status as a separate, albeit affiliated, partnership.

However, the Complaint sufficiently alleges both Andersen Worldwide's participation in the issuance of the false Andersen audit statements and its legal responsibility for the statements.[19] As alleged in the Complaint, Andersen and Andersen UK are member firms of Andersen Worldwide. ¶ 41. The Ridley Affidavit admits as much: "Andersen UK had a contractual relationship with Andersen Worldwide Societe

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[18] Schoppet's assertion that the "Complaint seeks to hold Schoppet liable for a host of WorldCom corporate misrepresentations," Schoppet Br. at 7, misses the mark. The Complaint does not allege that Schoppet's liability flows from his status as a WorldCom insider, but as the partner in charge of Andersen's audits of WorldCom during 2000 and before. In this position, Schoppet had control over Andersen's audit opinions – which no one, including Schoppet himself, denies were false and misleading.

[19] The NYSCRF's continuing investigation has confirmed that Andersen Worldwide – which shared Andersen's Chicago headquarters – operated as a single global partnership, the Andersen Worldwide Organization ("AWO"). This partnership was comprised of Andersen Worldwide and its member firms, including Andersen and Andersen UK. AWO and its member firms held themselves out as a single global network and employees exchanged e-mail labeled "ANDERSEN WO" – short for "worldwide organization." While the NYSCRF respectfully submits that it has sufficiently pled a §10(b) cause of action against Andersen UK and Andersen Worldwide, should the Court determine otherwise, the NYSCRF would request leave to replead its claim against these defendants based on this and other evidence that Lead Plaintiff has uncovered since the filing of the Complaint on October 11, 2002.

Cooperative ('AWSC'), pursuant to which it cooperated with Arthur Andersen LLP and other independent member firms in the provision of professional services within their respective jurisdictions." Ridley Aff. ¶ 3 (emphasis added). Thus, any statements made by Andersen in its audit statements are actionable not only against Andersen, but also against Andersen Worldwide. "[I]t is well established that under the law of partnerships, knowledge and actions of one partner are imputed to all others." See Engl v. Berg, 511 F. Supp. 1146, 1154 (E.D. Pa. 1981) (emphasis added); accord Northwestern Nat'l Bank v. Fox & Co., 102 F.R.D. 507, 511 (S.D.N.Y. 1984). This rule applies to both limited and general partners, Engl, 511 F. Supp. at 1154, and nothing in Central Bank undermines the applicability of this general principle of agency law. See Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 101 (2d Cir. 2001); Cromer II, 2002 WL 826847, at *7.

Andersen Worldwide attempts to escape liability by claiming that "allegations that accounting firm entities share a name and have some mutual association – even allegations that contain far more substance than those found in the instant complaint – are insufficient to state a claim for derivative liability." Andersen Worldwide Br. at 9. However, Andersen Worldwide may be held liable under fundamental agency principles, since Andersen Worldwide is comprised of "member firms," including Andersen and Andersen UK; the knowledge and actions of Andersen and Andersen UK are attributable to Andersen Worldwide; and, as shown above, the cases relied upon by Andersen Worldwide are factually and legally inapposite. [20] See supra n.10.

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[20] The line of discovery cases cited in note 9 of Andersen Worldwide's brief are easily distinguishable. In Goh v. Baldor Elec. Co., No. 3:98-MC-064-T, 1999 U.S. Dist.

D. Even If Andersen UK, Schoppet and Andersen Worldwide Had Not Made False and Misleading Statements, Which They Did, the Complaint Still Adequately Alleges Their Participation in a Scheme Sufficient to Impose § 10(b) and Rule 10b-5 Liability

Plaintiffs here have pleaded and are pursuing theories of recovery against Andersen UK, Schoppet and Andersen Worldwide that are well-grounded in the express language of §10(b) of the 1934 Act, which states in relevant part:

> Manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly …
>
> * * *
>
> (b) [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange … *any manipulative or deceptive device or contrivance* in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (italics added).

Rule 10b-5, which flows directly from the language of §10(b), provides:

> Employment of manipulative and deceptive devices
>
> It shall be unlawful for any person, directly, or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> a. *to employ any device, scheme or artifice to defraud*,
>
> b. to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in

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LEXIS 209, at *3, 7-8 (N.D. Tex. Jan. 13, 1999), the court refused to compel Ernst & Young LLP to produce documents in the alleged possession of Ernst & Young Singapore and Ernst & Young Thailand because there was no evidence of common ownership. In In re Citric Acid Litig., 191 F.3d 1090, 1106 (9th Cir. 1999), an antitrust case, the court declined to order Coopers & Lybrand United States to produce documents possessed by Coopers & Lybrand Switzerland because the former did not control its Swiss affiliate. And in In re DeLorean Motor Co. Litig., No. 83 CV-2137-DT, slip op. at 8 (E.D. Mich. Nov. 19, 1985), the court made a factual finding, based on several affidavits, that a worldwide partnership did not exist.

the light of the circumstances under which they were made, not misleading, or

c. to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (italics added).

Thus, not only does Rule 10b-5 forbid the making of "any untrue statement of a material fact," it also provides for scheme liability. Scheme liability is authorized by the text of Section 10(b). In Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Court referred to the dictionary definitions of the words used to describe the reach of Section 10(b) to find that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice.'" Id. at 199 n.20 (emphasis added) (quoting Webster's International Dictionary (2d ed. 1934)). The Court found that a "contrivance" means "'a scheme, plan, or artifice.'" Id.; see also Aaron v. SEC, 446 U.S. 680, 696 n.13 (1980). Thus, "scheme" is encompassed in the broad language of § 10(b).

As the court stated in In re Health Management: "Although the Supreme Court has eliminated secondary liability for aiders and abettors of securities fraud, primary liability under Rule 10b-5 may be imposed 'not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration.'" 970 F. Supp. at 209 (citing Central Bank, 511 U.S. at 191, and quoting S.E.C. v. First Jersey Securities, Inc., 101 F.3d at 1471). Indeed, as the Supreme Court recently stated in SEC v. Zandford, 535 U.S. 813 (2002), "[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of [§10(b) and Rule 10b-5]." Id. at 820 (quoting Marine

Bank v. Weaver, 455 US 551, 556 (1982)). Rather, "[I]t is enough that the scheme to defraud and the sale of securities coincide." Id. at 822.

While the Zandford case arose from a different factual setting, in which a broker sold securities with the undisclosed intent to misappropriate the proceeds of the sale, the decision of the Supreme Court demonstrates that a defendant may be liable for entering into a scheme to defraud – or participating either in or through others to do so – in such a fraudulent scheme. As the court stated in the In re Enron Corp. Sec. Derivative & ERISA Litig., 235 F. Supp. 2d 549, 580 (S.D. Tex. 2002) (citing In re Blech Sec. Litig., 961 F. Supp. 569, 582 (S.D.N.Y. 1997) case, "to state a claim for market manipulation under §10(b) and Rule 10b-5 against parties that employed manipulative and deceptive practices in a scheme to defraud, a plaintiff must allege (1) that it was injured (2) in connection with the purchase or sale of securities (3) by relying on a market for securities, (4) controlled or artificially affected by defendants' deceptive and manipulative conduct, and (5) the defendants engaged in the manipulative conduct with scienter." Enron and Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)).

Here, Lead Plaintiff has alleged that the Class was injured when its members purchased WorldCom securities in offerings and on the open market at prices artificially inflated, inter alia, by Andersen's "clean" audit statements. ¶¶ 343-44. The Complaint describes a fraudulent scheme perpetuated by all of the Defendants, including Andersen, Schoppet, Dick, Andersen UK and Andersen Worldwide. It further asserts that Schoppet and Dick, as Andersen audit partners; Andersen UK, as a provider of services in connection with the WorldCom audits; and Andersen Worldwide, as the international partnership within which Andersen and Andersen UK were member firms – and through

which Andersen UK cooperated with Andersen in the WorldCom audits – each participated in the fraudulent scheme.

For the foregoing reasons, the Complaint sufficiently states claims for Section 10(b) and Rule 10b-5 liability against defendants Schoppet, Andersen UK and Andersen Worldwide.[21]

II. THE COURT HAS JURISDICTION OVER ANDERSEN UK AND ANDERSEN WORLDWIDE

The Court has personal jurisdiction over Andersen UK and Andersen Worldwide because they have sufficient minimum contacts with the United States generally and specifically through their involvement in the WorldCom fraudulent scheme.

A. Standard For Dismissal on a Rule 12 Motion for Lack of Personal Jurisdiction

"A motion to dismiss under Rule 12 must be denied 'unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" In re Sumitomo Copper Litig., 120 F. Supp. 2d 328, 334 (S.D.N.Y. 2000) (internal citation omitted). Where, as here, jurisdiction is challenged prior to discovery, plaintiffs may defeat a motion to dismiss by "pleading in good faith ... legally sufficient allegations of jurisdiction." Jazini v. Nissan Motor Co., Ltd., 148 F.3d 181, 184 (2d Cir. 1998); Metropolitan Life Ins. Co. v. Robertson-Leco Corp., 84 F.3d 560, 566 (2d Cir. 1996). A plaintiff need only make a prima facie showing of jurisdiction to survive the motion. Whittaker v. American Telecasting, Inc., 261 F.3d 196, 208 (2d Cir. 2001); Ball v. Metallurgie Hoboken-Overpelt, S.A., 902 F.2d 194, 197 (2d Cir.

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[21] To the extent Andersen UK is relying on arguments earlier made by Andersen (see Andersen UK Br. at 12), Lead Plaintiff respectfully refers the Court to the NYSCRF's Jan. Br. at 70-81.

1990). "In evaluating Plaintiff's prima facie showing of jurisdiction, this Court must construe all pleadings and affidavits in the light most favorable to Plaintiffs and resolve all doubts in Plaintiffs' favor. In addition, this Court should draw all inferences in favor of Plaintiffs." Sumitomo, 120 F. Supp. 2d at 335 (internal citations omitted). See also Jacobs v. Felix Bloch Erben Verlag fur Buhne Film und Funk KG, 160 F. Supp. 2d 722, 731 (S.D.N.Y. 2001) (court "must construe all of the pleadings and affidavits in the light most favorable to the plaintiff and resolve all doubts in plaintiff's favor"); Madara v. Hall, 916 F.2d 1510, 1514 (11th Cir.1990) ("where the plaintiff's complaint and the defendant's affidavits . . . conflict, the district court must construe all reasonable inferences in favor of the plaintiff"); Hoffritz for Cutlery, Inc. v. Amajac, Ltd., 763 F.2d 55, 57 (2d Cir. 1985).[22]

As demonstrated herein, this Court may properly exercise personal jurisdiction over Andersen UK and Andersen Worldwide. Jurisdiction here is based on, among other provisions, Section 27 of the Exchange Act, 15 U.S.C. § 78. As specifically held by the Court of Appeals for the Second Circuit, "Congress meant § 27 to extend personal jurisdiction to the full reach permitted by the due process clause [of the Constitution]." Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1339 (2d Cir. 1972). Among the factors that satisfy the requirements of "due process" for purposes of determining whether personal jurisdiction may properly be exercised are the following: (1) doing business in the state, (2) doing an act in the state, and (3) causing an effect in

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[22] "Eventually personal jurisdiction must be established by a preponderance of the evidence, either at an evidentiary hearing or at trial." A.I. Trade Fin., Inc. v. Petra Bank, 989 F.2d 76, 79-80 (2d Cir. 1993). In the unlikely event that the Court was not prepared to exercise personal jurisdiction over Andersen UK and Andersen Worldwide at this time, this motion should be held in abeyance as Lead Plaintiff is entitled to discovery

the state by an act done elsewhere. Leasco, 468 F.2d at 1340. "[T]his reflects the modern notions that where a defendant has acted within a state or sufficiently caused consequences there, he may fairly be subjected to its judicial jurisdiction even though he cannot be served with process in the state. . . ." Id.

B. Andersen UK's and Andersen Worldwide's Contacts With the United States Satisfy Due Process Requirements

1. Andersen UK's and Andersen WorldWide's Conduct Satisfies the National Contacts Standard

When a court considers the propriety of the exercise of personal jurisdiction over a non-resident defendant in an action based upon a federal statute providing for nationwide service of process (like § 27 of the Exchange Act), "the relevant forum is the entire United States; in other words, the proper inquiry is whether the defendant has had minimum contacts with the United States." Pro-Fac Co-op, Inc. v. Alpha Nursery, Inc., 205 F. Supp. 2d 90, 99-100 (W.D.N.Y. 2002). The required contacts with the United States can be established either under the doctrine of "specific jurisdiction" or "general jurisdiction."

Specific jurisdiction may be exercised where an alleged injury arises out of or relates to actions by the defendant that are purposefully directed toward forum residents, and where jurisdiction would not otherwise offend "fair play and substantial justice." See Burger King Corp. v. Rudzewicz, 471 U.S. 462, 471-78 (1985); see also Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408, 414 n.8 (1984) ("where State exercises personal jurisdiction over a defendant in a suit arising out of or related to the defendant's contacts with the forum, the State is exercising 'specific jurisdiction' over the

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on the jurisdictional issue. See generally In re Ski Train Fire in Kaprun, Aus., 2002 U.S. Dist. LEXIS 14929 (S.D.N.Y. Aug. 14, 2002).

defendant."). General jurisdiction may be exercised when the defendant's contacts with the forum, unrelated to the lawsuit, are "continuous and systematic," thereby rendering jurisdiction "reasonable and just." Id. at 415.

Specific jurisdiction exists over Andersen UK and Andersen Worldwide for the following reasons: (1) their involvement in the WorldCom fraudulent scheme establishes "minimum contacts" because they demonstrate that Andersen UK and Andersen Worldwide purposefully directed their activities to the United States; and (2) the Court's exercise of jurisdiction over Andersen UK and Andersen Worldwide would be reasonable.

a. Andersen UK

The Court may assert personal jurisdiction over Andersen UK based on its involvement and knowledge of the audits of WorldCom's financial statements. As shown at pages 11-12, above, Andersen UK had numerous contacts with the United States when it was "instructed by Arthur Andersen LLP to perform specified procedures with respect to the financial statements of those subsidiaries and report to Arthur Andersen LLP in furtherance of Arthur Andersen LLP's work for WorldCom, Inc." See Ridley Aff. ¶ 6. [23] Andersen UK "accepted engagements to perform accountancy and related services in the UK for US persons or companies which had activities or subsidiaries in the UK" (id. at

[23] The Ridley Affidavit purports to summarize (a) Andersen UK's "limited contacts with the United States," and (b) Andersen UK's "limited involvement with WorldCom." Separate and apart from the well-pleaded allegations in the Complaint, see ¶¶ 41-42, 317-21, 427-40, the affidavit also provides a sufficient basis for finding that general and specific jurisdiction is proper over both Andersen UK and Andersen Worldwide. As stated in note 7 supra, should the Court determine that personal jurisdiction is not apparent from the record before the Court, the NYSCRF should be given a reasonable opportunity to conduct discovery with respect to the statements made in the Ridley Affidavit.

n.2) (emphasis added); sent its employees to United States practice offices of Andersen for various purposes (id. at ¶ 5(a)); sent its employees and partners to the United States in connection with work being performed for Andersen UK clients (id. at ¶ 5(b)); and further sent its partners and employees to the United States "for meetings regarding coordination with [Andersen Worldwide] and its member firms" (id. at ¶ 5(c)). Notably, as well, "certain partners of Andersen UK held positions or performed functions for [Andersen Worldwide], and spent time in the United States in that capacity" (id. at ¶ 5(b)).

The Ridley Affidavit also reveals that Andersen UK was the statutory auditor for ten of WorldCom's UK-based subsidiaries (id. at n.3). And, as noted above, it had direct dealings with Steven Brabbs – WorldCom's Director for International Finance and Control – who informed an audit partner and senior manager of Andersen UK of the improper accounting treatment sought by WorldCom's CFO with respect to underreporting line cost expenses in the first quarter of 2000 – which Andersen UK all but admits it did not investigate further. Through these numerous contacts with the United States, participating in the audit work for the second largest communications company in the United States, and performing audit services for its US-based affiliate, Andersen UK purposefully directed its activities at the United States, which are sufficient to establish its minimum contacts for jurisdictional purposes. See, e.g., Pinker v. Roche Holdings Ltd., 292 F.3d 361 (3d Cir. 2002).

Even if Andersen UK did not have any contact with the United States, the Court would still have jurisdiction over it because the Supreme Court has ruled that "within the rubric of 'purposeful availment,' jurisdiction may be exercised over a defendant whose only contact with the forum is the 'purposeful direction' of a foreign act which has an

effect in the forum." MTC Elec. Tech. Co. v. Leung, 889 F. Supp. 396, 400 (C.D. Cal. 1995) (quoting Calder v. Jones, 465 U.S. 783, 789 (1984)). Here, Andersen UK knew or should have known that by performing specified procedures in furtherance of Andersen's work for WorldCom that its acts would have a direct effect in the United States, and a direct impact on WorldCom investors in the United States. See Derensis v. Coopers & Lybrand Chartered Accountants, 930 F. Supp. 1003, 1014 (D.N.J. 1996) (personal jurisdiction existed over Canadian defendants who had no direct contacts with forum but allegedly approved and disseminated financial statements they knew would influence the price of securities traded on NASDAQ); Itoba Ltd. v. LEP Group PLC, 930 F. Supp. 36 (D. Conn. 1996) (personal jurisdiction is appropriate where director of foreign corporation knew or should have known a form he approved would be filed with the SEC and relied up on by potential investors); Landry v. Price Waterhouse Chartered Accountants, 715 F. Supp. 98, 101 (S.D.N.Y. 1989) (personal jurisdiction over a foreign defendant charged with control person liability because of his "behind the scenes" role in the subject transaction which he must have known would have an impact on stock trading within the United States); Reingold v. Deloitte Haskins & Sells, 599 F. Supp. 1241, 1259-60 (S.D.N.Y. 1984) (personal jurisdiction existed over Australian accounting firm that prepared an audit it knew would be relied upon by investors in the United States for claims arising out of the audit).

b. Andersen Worldwide

The Court may similarly assert personal jurisdiction over Andersen Worldwide based on its involvement in the WorldCom scheme. Andersen Worldwide argues that Swiss law would not recognize the Court's assertion of jurisdiction over it and, therefore,

this Court may not assert jurisdiction over it. Andersen Worldwide's argument should be rejected.

As alleged in the Complaint, "[t]hrough Andersen and Andersen UK, Andersen Worldwide was involved in the audits of WorldCom's financial statements during the Class Period." ¶ 42. Additionally, Andersen Worldwide is part of a worldwide organization that operates (or operated) as a single global partnership. Id. As the Ridley Affidavit concedes, one of the member firms in the Andersen Worldwide partnership is Andersen, and the Andersen Worldwide partnership was the vehicle through which its member firms entered into contractual relationships that provided for cooperation among the member firms in the provision of professional services to their various clients. Ridley Aff. ¶ 3. As the partnership that formed the basis of the cooperative work of Andersen and Andersen UK in the fraudulent scheme, Andersen Worldwide cannot credibly argue that the Court does not have jurisdiction over it.

The Court also may assert jurisdiction over Andersen Worldwide based on the actions of its members within the United States. As the Fifth Circuit stated in Lewis v. Fresne, 252 F.3d 352, 359 (5th Cir. 2001), "[a] partner's actions may be imputed to the partnership for the purpose of establishing minimum contacts" (quoting Sher v. Johnson, 911 F.2d 1357, 1366 (9th Cir. 1990)). In Lewis, the court found that minimum contacts existed between the defendant partnership and the forum based solely on the partner's actions within the forum. Id.

Similarly, here, minimum contacts exist between Andersen Worldwide and the forum, the United States, based on the actions of Andersen Worldwide's members, as well as the travels that members of the Andersen Worldwide partnership made to the United States for the purpose of carrying on the business of the partnership. As alleged

in the Complaint, Andersen Worldwide's members, Andersen and Andersen UK, played an integral part of auditing WorldCom's financial statements and knew of the fraud that was occurring in WorldCom's financial statements. ¶¶ 41-42. Thus, there are sufficient minimum contacts to support the assertion of personal jurisdiction over Andersen Worldwide.

2. The Court's Exercise of Jurisdiction over Andersen UK and Andersen Worldwide Is Reasonable

The Supreme Court has identified several factors to be considered in analyzing the reasonableness prong of the due process personal jurisdiction test: (1) the burden on the foreign entity if compelled to litigate here; (2) the interests of the United States as the forum for adjudicating the case; (3) the plaintiffs' interest in obtaining convenient and effective relief; (4) the most efficient resolution of the controversy; and (5) the availability of relief in another forum. See Asahi Metal Indus. Co. v. Superior Ct., 480 U.S. 102, 113-14 (1987). Based on all of these factors, exercising jurisdiction over Andersen UK and Andersen Worldwide is reasonable.

While Andersen UK averts to "the substantial burden imposed on Andersen UK in litigating [which] makes it unreasonable to exercise personal jurisdiction" (Andersen UK Br. at 16), it points to no specifics in terms of the burden, and does not even claim that the burden on Andersen UK would be greater than any other defendant in the case. On the other hand, as this Court has previously noted, there is an overwhelming interest in litigating all of plaintiffs' claims in this Consolidated Action. See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 1563412, at *4 (S.D.N.Y. Mar. 25, 2003) (denying motion to sever claims); In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 685099, at *1 (S.D.N.Y. Mar. 3, 2003) (denying motion to remand). Indeed, there is a great public interest within the United States concerning the

WorldCom debacle, and plaintiffs would suffer severe prejudice and inconvenience if certain claims, including the claims against Andersen UK and Andersen Worldwide, were not litigated in this one forum.

The sheer magnitude of the WorldCom fraud perpetuated on U.S. investors, among other factors discussed previously, supports a finding of personal jurisdiction over Andersen UK and Andersen Worldwide. Moreover, the Court has a strong interest in protecting the efficacy of the federal securities laws, and the Court's interest in furthering the policies underlying these laws – to ensure that disclosure obligations owed to the U.S. investing public are not violated – constitutes a further powerful reason to maintain jurisdiction over Andersen UK and Andersen Worldwide. They knew or should have known that their actions would adversely affect U.S. investors. They should not be heard to complain when haled into court here. See World-Wide Volkswagen v. Woodson, 444 U.S. 286, 297 (1980).

For the foregoing reasons, Andersen UK's and Andersen Worldwide's motions to dismiss for lack of personal jurisdiction should be denied.

In the alternative, in the event the Court determines that the Complaint does not provide a sufficient basis for exercising jurisdiction over Andersen UK or Andersen Worldwide, Lead Plaintiff respectfully submits that limited jurisdictional discovery should be allowed. See, e.g., Toys "R" Us, Inc. v. Step Two, S.A., 318 F.3d 446, 455-58 (3d Cir. 2003) (plaintiff entitled to jurisdictional discovery with regard to defendant's business activities in United States); In re DaimlerChrysler AG Sec. Litig., 197 F. Supp. 2d 86 (D. Del. 2002) (allowing discovery and denying motion to dismiss for lack of personal jurisdiction with leave for defendant to renew its motion after discovery was conducted). At this stage of the proceedings, discovery is stayed pursuant to the PSLRA,

but discovery on this issue may be conducted consistent with the PSLRA even though the motion to dismiss is pending. See In re Baan Co. Sec. Litig., 81 F. Supp. 2d 75, 83-84 (D.D.C. 2000).

CONCLUSION

For the foregoing reasons, and for those stated in the NYSCRF's Memorandum of Law filed January 24, 2003, the motions to dismiss should be denied.[24]

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[24] As the Court is aware, numerous investigations (including that of the NYSCRF) into the WorldCom debacle are continuing. As a result, if the Court determines that the Complaint is not sufficiently pled, Lead Plaintiff respectfully requests leave to amend. See Fed. R. Civ. P. 15(a); Foman v. Davis, 371 U.S. 178 (1962).