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	**JURY TRIAL DEMANDED**

CLASS ACTION COMPLAINT OF LEAD PLAINTIFF H. CARL McCALL, 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, ON BEHALF OF PURCHASERS AND ACQUIRERS OF ALL WORLDCOM, INC. PUBLICLY TRADED SECURITIES

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
Max W. Berger (MB-5010)
John P. Coffey (JC-3832)
Steven B. Singer (SS-5212)
Beata Gocyk-Farber (BGF-5420)
Jennifer L. Edlind (JE-9138)
Joseph A. Fonti (JF-3201)
1285 Avenue of the Americas
New York, New York 10019
(212) 554-1400

BARRACK, RODOS & BACINE
Leonard Barrack
Gerald J. Rodos
Jeffrey W. Golan
Jeffrey A. Barrack
Pearlette V. Toussant
3300 Two Commerce Square
2001 Market Street
Philadelphia, Pennsylvania 19103
(215) 963-0600

Attorneys for Lead Plaintiff H. Carl McCall, Comptroller of the State of New York, as Administrative Head of New York State and Local Retirement Systems and as Trustee of the New York State Common Retirement Fund, and Co-Lead Counsel for the Class

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H. Carl McCall, 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"), brings this federal securities law class action individually and on behalf of all other persons and entities who purchased or acquired publicly traded shares, bonds or notes of WorldCom, Inc. ("WorldCom" or the "Company") between April 29, 1999 and June 25, 2002 (the "Class Period"), based on the misrepresentations and material omissions asserted herein, and were injured thereby.

NATURE OF ACTION

1. This case arises from the largest corporate accounting scandal in U. S. history, a fraud that has inflicted billions of dollars of damage across a broad swath of the investing public and triggered the largest bankruptcy in U.S. history. The fraud asserted in this Complaint was perpetrated by, among others, senior officers of WorldCom, its directors, its outside auditor Arthur Andersen LLP ("Andersen"), the investment banking firm of Salomon Smith Barney, Inc.

("Salomon") and a syndicate of underwriters, in violation of the Securities Act of 1933 (the "Securities Act") and the Securities and Exchange Act of 1934 (the "Exchange Act").

2. The scheme entailed the dissemination of materially false and misleading information quarterly and annual financial statements of WorldCom in press releases; in each of its filings with the United States Securities and Exchange Commission ("SEC") during the period from April 29, 1999 through May 15, 2002; in the registration statements issued for acquisitions initiated by WorldCom during this time period; and in the registration statements for Offerings of Senior Notes ("Notes") issued by WorldCom. The cornerstone of the scheme involved gross overstatements of earnings -- well over $7 billion -- in WorldCom's financial statements for the years 1999, 2000, 2001 and the first quarter of 2002.

3. As was ultimately revealed, this scheme was simple to perpetrate and even easier to discover, had the gatekeepers for the investing public -- the auditors, underwriters and ostensibly independent research analysts -- not averted their eyes. After each quarter, senior WorldCom officers would review the Company's results in order to determine how far those results fell below the consensus estimates of Wall Street analysts; they would then conspire to hide what in some cases were nine-figure shortfalls by making bogus entries in WorldCom's general ledger, reclassifying line cost expenses to a variety of capital asset accounts without any supporting documentation or legitimate business rationale. According to the former WorldCom Controller who played a major role in the execution of the fraud: "I was instructed on a quarterly basis by senior management to ensure that entries were made to falsify WorldCom's books to reduce WorldCom's reported actual costs and therefore to increase WorldCom's reported earnings." *See* "Former WorldCom Exec Pleads Guilty," Associated Press, Sept. 27, 2002. The magnitude of this part of the fraud was first disclosed on June 25, 2002, when WorldCom announced that it would

have to restate the certified financial results for all four quarters of 2001 and the first quarter of 2002 because it had, among other things, improperly treated more than $3.8 billion in ordinary costs as capital expenditures, in violation of generally accepted accounting principles ("GAAP").

4. These practices were patently criminal -- the former Controller and three other WorldCom executives have recently pleaded guilty to securities fraud and related charges -- but they enabled WorldCom to report earnings that were inflated by billions of dollars. This in turn enabled the Company to meet Wall Street's estimates, thereby artificially inflating the price of WorldCom's stock and bonds in the secondary market. In addition, the scheme enabled WorldCom and one of its principal underwriters, Salomon, to defraud investors into purchasing approximately $17 billion in ostensibly "investment grade" Notes in May 2000 and May 2001 when, in fact, the Company was in dire financial straits.

5. The Company has further admitted that senior WorldCom executives also manipulated reserves -- amounts set aside primarily in connection with WorldCom's mergers to cover bad debt, merger costs and other problems -- by setting aside too high a dollar figure and then dipping back into the reserve accounts to make up for gaps in projected and actual profits. WorldCom has to date estimated the impact of these maneuvers as adding an additional $3.3 billion in improperly reported earnings before interest, taxes, depreciation and amortization ("EBITDA") for the years 1999, 2000, 2001 and the first quarter 2002. In sum, as of the filing of this Complaint, WorldCom had admitted that its financial statements for the years 1999 through 2002 were overstated by well over $7 billion -- and there have been recent reports that an additional $2 billion of restatements may be forthcoming. "WorldCom May Revise Results by $2 Billion," Bloomberg News, September 19, 2002 (reporting on article in The Wall Street Journal). WorldCom has also stated that it will likely write off all $50 billion in goodwill previously carried on the books.

6. WorldCom's disclosures have wreaked havoc on the financial markets. WorldCom common stock dropped from a Class Period high of approximately $65 per share to pennies, leading to its delisting from the NASDAQ exchange. The impact on WorldCom bonds was also catastrophic. For example, on June 27, 2002, WorldCom 8% Notes, which had a value of $62.25 a few days prior to the announcement, traded at $11, a loss of over 80%. These Notes once traded as high as $106. Published estimates place the losses of WorldCom bondholders alone at more than $9 billion. On July 21, 2002, WorldCom filed for protection under Chapter 11 of the Bankruptcy Code in this District – the largest bankruptcy ever.

7. The reaction of the Nation's senior leadership to the unfolding WorldCom debacle was immediate and fierce. The President called the revelations "outrageous." The Chairman of the Securities and Exchange Commission ("SEC") labeled the accounting manipulations "fraud, not mistake." On June 26, 2002, the day after WorldCom's announcement of the $3.8 billion restatement, the SEC filed a complaint in this District accusing the Company of securities fraud. One day later, Congress launched an investigation of WorldCom. On July 8, 2002, the House Committee on Financial Services held a hearing on WorldCom. Rather than answer the Committee's questions concerning what had occurred at WorldCom, Bernard Ebbers, WorldCom's former CEO, and Scott Sullivan, WorldCom's former CFO, invoked their Fifth Amendment right against self-incrimination and refused to testify.

8. The scope and audacity of the fraud has also triggered a swift response by the United States Attorney for this District. Sullivan and WorldCom's former Controller, David Myers, were arrested on August 1, 2002 and charged with seven felonies, including securities fraud, conspiracy to commit securities fraud, and filing false statements with the SEC. Myers pleaded guilty to those charges several weeks later; Sullivan did not, and was indicted on those

charges on August 28, 2002. Named as a co-defendant with Sullivan in that indictment was Buford Yates, Jr., the former WorldCom Director of General Accounting. Yates pleaded guilty to those charges on October 7, 2002. On October 10, 2002, two other senior WorldCom employees, Betty Vinson and Troy Normand, pleaded guilty to charges of securities fraud and conspiracy to commit securities fraud. Myers, Yates, Vinson and Normand, who are cooperating with the U.S. Attorney in his continuing investigation of the WorldCom fraud, each told the Court that they were instructed to manipulate the books at WorldCom by their superiors in management.

9. The fraud originated with Senior WorldCom management, but it could not have succeeded to the extent it did without the active participation and collaboration of Salomon. Salomon was lead underwriter for two huge public offerings of WorldCom Notes that generated a staggering $17 billion for WorldCom in one twelve-month span. Like the other underwriters on those debt offerings, Salomon is liable under § 11 of the Securities Act for the materially false and misleading statements regarding WorldCom's financial condition that were set forth in the registration statements issued in connection with those offerings. But as described more fully below, Salomon is also liable for fraud in connection with those offerings because, under § 10(b) of the Exchange Act, at the time the offerings were made, Salomon knew, or recklessly disregarded, that WorldCom's financial condition was not as the offering documents represented it to be.

10. Salomon's knowledge, or reckless disregard, of the falsity of statements regarding WorldCom's financial condition was not limited to the two bond offerings. Throughout the Class Period, Salomon's "star" telecommunications analyst, Jack Grubman, issued dozens of analyst reports touting WorldCom and urging investors to, in Grubman's words, "load up the truck" with WorldCom stock. However, as was ultimately revealed, Grubman's analyst reports and the public offerings underwritten by Salomon -- which generated tens of millions of dollars in underwriting

fees for that firm -- were part of a shell game that WorldCom and Salomon played on investors. Purchasers of WorldCom's stocks and bonds were never told that the purportedly "independent" raves from Grubman had in fact been purchased as an integral part of the investment banking services that Salomon provided to WorldCom.

11. Nor were investors apprised that WorldCom officers and directors received millions in profits through "hot" offerings in initial public offerings ("IPOs"). From the late 1990s through 2001, Salomon and Grubman routinely allocated to WorldCom executives, including Ebbers, extremely valuable, coveted shares in companies that Salomon was about to take public. Ebbers sold many of these shares soon after the IPO, making millions of dollars. The NYSCRF's investigation to date has determined that when then-CFO Sullivan complained to Salomon and Ebbers that his share of the allocations was in his view too low, Salomon responded by increasing Sullivan's allocation -- and Ebbers pacified his confederate by sharing his profits from these sales. In turn, Ebbers and Sullivan ensured that the lion's share of WorldCom's investment banking business went to Salomon; between 1997 and 2001, Salomon made more than $107 million from this relationship. As noted above, as a crucial part of this illicit arrangement, Grubman agreed to write extremely positive -- and materially false -- research reports about WorldCom, continually pumping the stock regardless of merit. When the analytical "free cash flow" model that Grubman used to value telecom companies threatened to expose WorldCom's financial deterioration on the eve of a $5 billion debt offering Salomon was leading in 2000, Grubman abruptly changed to a different "cash earnings" model for WorldCom -- even though he continued to use the free cash flow model for all the other telecom stocks for another two years. Unbeknownst to investors, Grubman's compensation was dependent upon the amount of investment banking business he brought in, and WorldCom was his cash cow. Thanks largely to WorldCom, Grubman made

approximately $20 million per year in his final years at Salomon, and Grubman knew that would continue only so long as WorldCom's stock remained at levels high enough to allow the Company to continue to pursue its acquisitions and conduct public offerings.

12. As explained more fully below, the NYSCRF's investigation has illuminated yet another fact about this nefarious relationship between Ebbers and Salomon, one which to date has apparently not been publicly disclosed. In the fall of 1999, Grubman and others at Salomon helped Ebbers obtain secret loans on the order of $679 million from The Travelers Insurance Company, which like Salomon is wholly owned by Citigroup. To disguise the identity of the borrower, the loans were made to a shell corporation named Joshua Timberlands LLC, which Ebbers set up in Mississippi just a few weeks before the first loan was made. Ebbers then used that money to buy over 460,000 acres of land in Alabama, Tennessee and Mississippi from the Kimberley-Clark Company for his own personal use. Several months after Ebbers received these loans from Citigroup's Travelers, WorldCom selected Citigroup's Salomon as lead underwriter for its $5 billion bond offering in 2000, and then for its approximately $12 billion bond offering -- the largest in history -- in 2001. In addition, the collateral for the Travelers loans was apparently not the real estate purchased with the money (which cost Ebbers less than $400 million), but rather Ebbers' holdings in WorldCom stock. Thus, by early 2000, Citigroup, Salomon's parent, was on the hook for huge loans whose value rode on the strength of WorldCom's stock -- powerful incentive to make sure that the public perception of the Company, and its share price, did not suffer.

13. None of these facts was disclosed to WorldCom investors. Class members were never informed of the quid pro quo arrangements between WorldCom and Salomon, and that each of the bond offering registration statements and "buy" recommendations upon which investors relied was an integral part of an investment banking package of services. They were not informed

that Grubman's positive ratings for WorldCom were issued in exchange for WorldCom's investment banking business, and that Grubman's compensation depended on issuing these ratings. They were not informed of the $499 million loan to WorldCom's CEO by the corporate sibling of the lead underwriter for WorldCom's bond offerings. Had these and other material facts discussed herein been shared with investors, the price of WorldCom's securities would never have reached the heights they attained.

JURISDICTION AND VENUE

14. Certain of the claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§ 78j(b), 78r and 78t(a), and Rule 10b-5 promulgated thereunder by the SEC, 17 C.F.R. § 240.10b-5. Certain other of the claims asserted herein arise under and pursuant to Sections 11, 12 and 15 of the Securities Act, 15 U.S.C. §§ 77k, 77l(a)(2) and 77o.

15. This Court has jurisdiction over the subject matter of this action pursuant to Section 22 of the Securities Act, 15 U.S.C. § 77v, Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and pursuant to 28 U.S.C. § 1331, in that this is a civil action arising under the laws of the United States.

16. Venue is proper in this District pursuant to Section 22 of the Securities Act, 15 U.S.C. § 77v, Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and pursuant to 28 U.S.C. § 1391(b). Many of the acts and transactions constituting the violations of law alleged herein, including the preparation, issuance, and dissemination of materially false and misleading statements, occurred in this District. For instance, WorldCom's quarterly and year-end financial statements were transmitted to the New York, New York offices of Merrill Communications LLC, a filing agent that assists companies in electronically filing periodic reports with the SEC, and were

thereafter transmitted electronically by a Merrill Communications subcontractor, located in New York, New York, to the SEC and were filed electronically with the SEC. In addition, certain of the individual defendants reside in this District, as do most of the underwriter defendants.

17. In connection with the acts alleged in this Complaint, defendants, directly and indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the United States mails, interstate telephone communications and the facilities of the national securities exchanges.

PARTIES

Lead Plaintiff

18. The NYSCRF purchased or acquired WorldCom securities during the Class Period and suffered damages as a result of the federal securities law violations alleged herein. As established by Article 9 of the New York Retirement and Social Security Law, the NYSCRF holds and invests the assets of the New York State and Local Employees' Retirement System and the New York State and Local Police and Fire Retirement System (combined, the "New York State Local Retirement Systems"). The NYSCRF is the second largest public pension fund in the nation. As of March 31, 2002, it had approximately 950,000 active members, retirees, and other beneficiaries and over $112 billion in assets. H. Carl McCall, the Comptroller of the State of New York, is the sole trustee of the NYSCRF. During the Class Period, the NYSCRF purchased 15,315,138 shares of WorldCom stock and 267,499 shares of WorldCom MCI tracking stock, and lost more than $300 million as a result. On August 12, 2002, the Honorable Denise L. Cote appointed the NYSCRF as Lead Plaintiff for this litigation.

Additional Named Plaintiffs

19. The Fresno County Employees Retirement Association ("FCERA") purchased or acquired WorldCom securities during the Class Period and suffered damages as a result of the federal securities law violations alleged herein. FCERA is an entity formed under the State of California's County Employees' Retirement Law of 1937. FCERA invests funds for the exclusive purpose of providing retirement compensation, death benefits and disability benefits to participants in the pension or retirement system for Fresno County employees and their beneficiaries. As of June 30, 2002, it had approximately 10,200 active members, retirees, and other beneficiaries and over $1.5 billion in assets. During the Class Period, FCERA purchased 136,900 shares of WorldCom stock and $8,198,295.50 worth of WorldCom debt securities, including over $3,000,000 of Notes in the May 15, 2001 Note Offering (the "2001 Offering or the "2001 Note Offering"). FCERA, which is not a Lead Plaintiff in this Action, joins in this action as a named plaintiff.

20. The County of Fresno, California ("Fresno") purchased or acquired WorldCom securities during the Class Period and suffered damages as a result of the federal securities law violations alleged herein. Fresno is a political subdivision of the state of California that invests general funds of the County of Fresno, California under California law for the benefit of its citizens. During the Class Period, Fresno purchased $6,352,697.37 worth of Notes in the May 24, 2000 Note Offering (the "2000 Offering, or the "2000 Note Offering"). Fresno, which is not a Lead Plaintiff in this Action, joins in this action as a named plaintiff.

21. HGK Asset Management, Inc. ("HGK") purchased or acquired WorldCom securities during the Class Period and suffered damages as a result of the federal securities law violations alleged herein. HGK is a registered investment advisor under the Investment Advisors Act of

1940, 15 U.S.C. § 80b-1, et seq. and acts as a fiduciary to its union-sponsored pension and benefit plan clients under the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 et seq. As of October 10,2002, HGK had more than 80 client relationships, in addition to representing thousands of individual retirees, and managed over $2 billion in assets. During the Class Period, HGK purchased $129,486,989 worth of WorldCom debt securities, including approximately $43,000,000 of Notes in the 2000 Offering, and over $29,000,000 in the 2001 Offering. HGK, which is not a Lead Plaintiff in this Action, joins in this action as a named plaintiff.

Defendants

22. Defendant Bernard J. Ebbers ("Ebbers") was President, Chief Executive Officer and a Director of WorldCom at all relevant times until approximately April 29, 2002, when he was forced to resign from the Company. Ebbers signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2001; and the registration statements related to the 2000 Offering and the 2001 Offering.

23. Defendant Scott D. Sullivan ("Sullivan") was Chief Financial Officer and a Director of WorldCom at all relevant times until June 25, 2002, when he was terminated by the Company. Between April 30, 2002 and June 25, 2002, he also served as Executive Vice President. Sullivan signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; the Company's Quarterly Reports for each quarter of the years 1999 through 2001 and the first quarter of 2002 on Forms 10-Q; each of its registration statements for WorldCom acquisitions between 1999 and 2001; and the registration statements related to the 2000 Offering and 2001 Offering. On August 1, 2002, Sullivan and former WorldCom Controller David F. Myers were arrested by the Federal Bureau of Investigation (“FBI”) and charged in a criminal complaint dated July 31, 2002

(No. 02 Mag. 1511 (S.D.N.Y.), the "Criminal Complaint") with seven felonies, namely, conspiracy to commit securities fraud, securities fraud, and five false filings with the SEC. On August 28, 2002, a federal grand jury empanelled in this District returned an indictment (No. 02 Crim. 1144 (S.D.N.Y.), the "Indictment"), which charged Sullivan and former WorldCom Director of General Accounting, Buford Yates, Jr., with seven felonies, namely, conspiracy to commit securities fraud, securities fraud and five counts of false filings with the SEC.

24. Defendant David F. Myers ("Myers") was Controller and a Senior Vice President of WorldCom at all relevant times until June 25, 2002, when he resigned his positions at WorldCom. As noted above, Myers was charged with seven felonies in the Criminal Complaint and, like Sullivan, was arrested by the FBI on August 1, 2002. On September 26, 2002, Myers pled guilty to a three count criminal information charging him with conspiracy, securities fraud and filing false documents with the SEC.

25. Defendant Buford Yates, Jr. ("Yates") was, at all relevant times, the Director of General Accounting at WorldCom. As noted above, Yates was charged with seven felonies in the Indictment. He was arrested by the FBI on August 28, 2002. On October 7, 2002, Yates pled guilty to two counts of the Indictment, namely, conspiracy to commit securities fraud and securities fraud.

26. Defendant James C. Allen ("Allen") was, at all relevant times, a Director of WorldCom and a member of the Audit Committee of the Board. Allen signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2001; and the registration statements related to the 2000 Offering and 2001 Offering.

27. Defendant Judith Areen ("Areen") was, at all relevant times, a Director of WorldCom and a member of the Audit Committee of the Board. Areen signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2002; and the registration statements related to the 2000 Offering and 2001 Offering.

28. Defendant Carl J. Aycock ("Aycock") was, at all relevant times, a Director of WorldCom. Aycock signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2001; and the registration statements related to the 2000 Offering and 2001 Offering.

29. Defendant Max E. Bobbitt ("Bobbitt") was, at all relevant times, a Director of WorldCom and the Chairman of the Audit Committee of the Board. Bobbitt signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2001; and the registration statements related to the 2000 Offering and 2001 Offering.

30. Defendant Francesco Galesi ("Galesi") was, at all relevant times, a Director of WorldCom and a member of the Audit Committee of the Board. Galesi signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2001; and the registration statements related to the 2000 Offering and 2001 Offering.

31. According to WorldCom's filings with the SEC, defendants Bobbitt, Allen, Areen and Galesi were members of the Board's Audit Committee from 1999 through 2002. According to WorldCom's Proxy Statement, the Audit Committee performed the following functions during the relevant period: (a) review of periodic financial statements; (b) communication with independent

accountants; (c) review of internal accounting controls; and (d) recommending selection of independent accountants to the Company's Board of Directors.

32. Defendant Clifford L. Alexander, Jr. ("Alexander") was, at all relevant times, a Director of WorldCom. Alexander signed the Company's annual reports for the years 1999 and 2000 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2002; and the registration statements related to the 2000 Offering and the 2001 Offering.

33. Defendant Stiles A. Kellett, Jr. ("Kellet"), was, at all relevant times, a Director of WorldCom and Chairman of the Board's Compensation Committee. Kellett signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2002; and the registration statements related to the 2000 Offering and the 2001 Offering.

34. Defendant Gordon S. Macklin ("Macklin") was, at all relevant times, a Director of WorldCom. Macklin signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2002; and the registration statements related to the 2000 Offering and the 2001 Offering.

35. Defendant John A. Porter ("Porter") was, at all relevant times, a Director of WorldCom. Porter signed the Company's annual report for the year 1999 on Form 10-K; the registration statement for WorldCom's acquisition of Skytel Communications in 1999; and the registration statements related to the 2000 Offering and the 2001 Offering.

36. Defendant Bert C. Roberts, Jr. ("Roberts") was, at all relevant times a Director of WorldCom and further served as Chairman of the Board. Roberts signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for

WorldCom acquisitions between 1999 and 2002; and the registration statements related to the 2000 Offering and the 2001 Offering.

37. Defendant John W. Sidgmore ("Sidgmore"), was, at all relevant times, a Director of WorldCom and further served as Vice Chairman. Sidgmore signed the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2002; and the registration statements related to the 2000 Offering and the 2001.

38. Defendant Lawrence C. Tucker ("Tucker") was, from May 1995 to November 2000 a Director of WorldCom. Tucker signed the Company's annual reports for the year 1999 on Form 10-K; the registration statement for WorldCom's acquisition of Skytel Communications in 1999; and the registration statement related to the 2000 Offering.

39. Defendants Ebbers, Sullivan, Myers, Yates, Allen, Areen, Aycock, Bobbitt, Galesi, Alexander, Kellett, Macklin, Roberts, Sidgmore, and Tucker are collectively referred to herein as the "Individual WorldCom Defendants."

40. Defendant Arthur Andersen LLP ("Andersen") was formerly a "Big 5" firm of certified public accountants. At all times relevant to this action, Andersen provided auditing and accounting services to WorldCom, including but not limited to, undertaking audits of the Company's year-end financial statements and reviews of its quarterly statements. In connection therewith, Andersen issued unqualified audit reports relating to WorldCom's financial statements, for inclusion in each of the Company's annual reports for the years 1999 through 2001 on Forms 10-K; each of its registration statements for WorldCom acquisitions between 1999 and 2002; and for the registration statements related to the 2000 Offering and 2001 Offering. Andersen further performed reviews on each of WorldCom's quarterly financial statements issued with respect to the

first three quarters of 1999, the first three quarters of 2000, the first three quarters of 2001, and the first quarter of 2002. On or about May 14, 2002, Andersen was replaced as WorldCom's outside auditor by KPMG LLP.

41. Defendant Andersen UK ("Andersen UK") is a British public accounting firm and a member of defendant Andersen Worldwide SC. During the Class Period, Andersen UK audited WorldCom's financial statements with Andersen.

42. Defendant Andersen Worldwide SC ("Andersen Worldwide") is a Swiss Societe Cooperative and serves as the umbrella organization for its member firms worldwide. Arthur Andersen is the member firm of Andersen Worldwide in the United States, and Andersen UK is the member firm of the Andersen Worldwide in the United Kingdom. Through Andersen and Andersen UK, Andersen Worldwide was involved in the audits of WorldCom's financial statements during the Class Period.

43. Defendants Mark Schoppet ("Schoppet") and Melvin Dick ("Dick"), and others not presently known to Plaintiffs, were certified public accountants ("CPAs") and senior Andersen partners responsible for audits of Worldcom's financial statements. Schoppet was the audit engagement partner in connection with Andersen's audits of the Company's financial statements for 2000 and prior years. Dick was the audit engagement partner in connection with Andersen’s audits of the Company’s financial statements for 2001.

44. Defendants Andersen, Andersen UK, Andersen Worldwide, Schoppet and Dick are collectively hereafter referred to as the “Andersen Defendants.”

45. Defendant Salomon Smith Barney Inc. ("Salomon") is currently a subsidiary of defendant Citigroup, Inc., a financial services institution that, through its subsidiaries and divisions, provides commercial and investment banking services and commercial loans to corporate entities.

Salomon was the book running manager and co-lead underwriter for the 2000 Offering. It sold $518,750,000 worth of the 8% Notes due May 15, 2006, which were sold in that Offering. Salomon also was the joint book-runner and co-lead underwriter for the 2001 Offering. In connection with that Offering, Salomon sold $480,000,000 worth of the 6.50% Notes due 2004; $1,290,000,000 worth of the 7.50% Notes due 2011; $1,472,000,000 worth of the 8.25% Notes due 2031; and through Salomon Brothers International Limited, €403,125,000 worth of the Euro 6.75% Notes due 2008 and £160,000,000 worth of the Sterling 7.25% Notes due 2008. Salomon further served in numerous other capacities with respect to, among other things, WorldCom's acquisitions and mergers during the Class Period, WorldCom's corporate stock option plans, and WorldCom employees' stock transactions. According to a Complaint recently filed by the New York Attorney General against Ebbers and other beneficiaries of Salomon's IPO "spinning" scheme (described in paragraphs _-_ below), between October 1997 and February 2002, Salomon advised WorldCom on approximately twenty-three investment banking deals and garnered investment banking fees of approximately $107 million from those deals.

46. Defendant Citigroup, Inc. ("Citigroup"), an international financial services company, was formed in 1998 by the merger of Citicorp and Travelers Group. Citigroup, which services more than 200 million customer accounts in more than 100 countries, is the corporate parent and 100% owner of defendant Salomon and reports Salomon's financial results in its consolidated financial statements. Through its corporate control over its subsidiary, Salomon, Citigroup was able to control, and did control, the financial analyst reports published by Salomon during the Class Period.

47. Defendant Jack B. Grubman ("Grubman") was the primary telecommunications industry analyst at Salomon from the fall of 1994 until August 15, 2002, when he resigned from Salomon.

48. Defendant J.P. Morgan Chase & Co. ("J.P. Morgan") is a financial services institution that, through its subsidiaries and divisions, provides commercial and investment banking services and advisory services. J.P. Morgan was co-lead underwriter for the 2000 Offering. It sold $375,000,000 worth of the 8% Notes due May 15, 2006, which were sold in that Offering. J.P. Morgan also was the joint book runner and co-lead underwriter for the 2001 Offering. In connection with that Offering, J.P. Morgan sold $480,000,000 worth of the 6.50% Notes due 2004; $1,290,000,000 worth of the 7.50% Notes due 2011; $1,472,000,000 worth of the 8.25% Notes due 2031; and through J.P. Morgan Securities Ltd., €403,125,000 worth of the Euro 6.75% Notes due 2008 and £160,000,000 worth of the Sterling 7.25% Notes due 2008.

49. Defendant Banc of America Securities LLC ("Banc of America") is a subsidiary of Bank of America Corp., a financial services institution that, through its subsidiaries and divisions, provides commercial and investment banking services and commercial loans to corporate entities. Banc of America was an underwriter for the 2000 Offering, and sold $93,750,000 worth of the 8% Notes due May 15, 2006, which were sold in that Offering. Banc of America was also a joint lead manager of the 2001 Offering. In connection with that Offering, Banc of America sold $165,000,000 worth of the 6.50% Notes due 2004; $440,000,000 worth of the 7.50% Notes due 2011; $506,000,000 worth of the 8.25% Notes due 2031; and, through Banc of America Securities Limited, €137,500,000 worth of the Euro 6.75% Notes due 2008 and £55,000,000 worth of the Sterling 7.25% Notes due 2008. During and prior to the Class Period, Banc of America further extended personal loans to defendant Ebbers, in amounts totaling approximately $200 million,

backed by Ebbers' own WorldCom stock as collateral. When the price of WorldCom fell, Banc of America made certain margin calls, which were paid by loans extended by WorldCom's Board to Ebbers.

50. Defendant Deutsche Bank Securities Inc., now known as Deutsche Bank Alex. Brown Inc. ("Deutsche Bank"), is a subsidiary of Deutsche Bank AG, a financial services institution that, through its subsidiaries and divisions, provides commercial and investment banking services and commercial loans to corporate entities. Deutsche Bank was an underwriter for the 2000 Offering. It was also a joint lead manager of the 2001 Offering. In connection with that Offering, Deutsche Bank sold $120,000,000 worth of the 6.50% Notes due 2004; $320,000,000 worth of the 7.50% Notes due 2011; $368,000,000 worth of the 8.25% Notes due 2031; and, through Deutsche Bank AG London, €100,000,000 worth of the Euro 6.75% Notes due 2008 and £40,000,000 worth of the Sterling 7.25% Notes due 2008.

51. Defendant Chase Securities Inc. ("Chase") was an underwriter for the 2000 Offering, and sold $93,750,400 worth of the 8% Notes due May 15, 2006 issued in that Offering.

52. Defendant Lehman Brothers Inc. ("Lehman Brothers") was an underwriter for the 2000 Offering, and sold $93,750,000 worth of the 8% Notes due May 15, 2006 issued in that Offering.

53. Defendant Blaylock & Partners, L.P. ("Blaylock") was an underwriter for the 2000 Offering, and sold $18,750,000 worth of the 8% Notes due May 15, 2006 issued in that Offering. Blaylock also was a co-manager of the 2001 Offering and, in connection with that Offering, sold $7,500,000 worth of the 6.50% Notes due 2004; $20,000,000 worth of the 7.50% Notes due 2011; $23,000,000 worth of the 8.25% Notes due 2031; €6,250,000 worth of the Euro 6.75% Notes due 2008; and £2,500,000 worth of the Sterling 7.25% Notes due 2008.

54. Defendant Credit Suisse First Boston Corp. ("CSFB") was an underwriter for the 2000 Offering, and sold $18,750,000 worth of the 8% Notes due May 15, 2006 issued in that Offering.

55. Defendant Goldman, Sachs & Co. ("Goldman Sachs") was an underwriter for the 2000 Offering, and sold $18,750,000 worth of the 8% Notes due May 15, 2006 issued in that Offering.

56. Defendant UBS Warburg LLC ("UBS Warburg") was an underwriter for the 2000 Offering, and sold $18,750,000 worth of the 8% Notes due May 15, 2006 issued in that Offering.

57. Defendant ABN/AMRO Inc. ("ABN/AMRO") is a large integrated financial services institution that provides commercial and investment banking services and commercial loans to corporate entities. ABN/AMRO was a joint lead manager for the 2001 Offering. In connection with that Offering, ABN/AMRO sold $120,000,000 worth of the 6.50% Notes due 2004; $320,000,000 worth of the 7.50% Notes due 2011; $368,000,000 worth of the 8.25% Notes due 2031; and, through ABN AMRO Bank N.V., €100,000,000 worth of the Euro 6.75% Notes due 2008 and £40,000,000 worth of the Sterling 7.25% Notes due 2008.

58. Defendant Utendahl Capital ("Utendahl") was a co-manager of the 2001 Offering. In connection with that Offering, Utendahl sold $7,500,000 worth of the 6.50% Notes due 2004; $23,000,000 worth of the 8.25% Notes due 2031; and, through Wendahl Capital Partners, L.P., £2,500,000 worth of the Sterling 7.25% Notes due 2008.

59. Defendant Tokyo-Mitsubishi International plc ("Mitsubishi") was a senior co-manager for the 2001 Offering. In connection with that Offering, Mitsubishi sold $30,000,000 worth of the 6.50% Notes due 2004; $80,000,000 worth of the 7.50% Notes due 2011; $92,000,000

worth of the 8.25% Notes due 2031; €25,000,000 worth of the Euro 6.75% Notes due 2008; and £10,000,000 worth of the Sterling 7.25% Notes due 2008.

60. Defendant Westdeutsche Landesbank Girozentrale ("Westdeutsche") was a senior co-manager for the 2001 Offering. In connection with that Offering, Westdeutsche sold $30,000,000 worth of the 6.50% Notes due 2004; $80,000,000 worth of the 7.50% Notes due 2011; $92,000,000 worth of the 8.25% Notes due 2031; €25,000,000 worth of the Euro 6.75% Notes due 2008; and £10,000,000 worth of the Sterling 7.25% Notes due 2008.

61. Defendant BNP Paribas Securities Corp. ("BNP") was a co-manager of the 2001 Offering. In connection with that Offering, BNP sold $15,000,000 worth of the 6.50% Notes due 2004; $40,000,000 worth of the 7.50% Notes due 2011; $46,000,000 worth of the 8.25% Notes due 2031; and, through BNP Paribas, €12,500,000 worth of the Euro 6.75% Notes due 2008 and £5,000,000 worth of the Sterling 7.25% Notes due 2008.

62. Defendant Caboto Holding SIM S.p.A. ("Caboto") was a co-manager of the 2001 Offering. In connection with that Offering, Caboto sold $15,000,000 worth of the 6.50% Notes due 2004; $40,000,000 worth of the 7.5% Notes due 2011; $46,000,000 worth of the 8.25% Notes due 2031; €12,500,000 worth of the Euro 6.75% Notes due 2008; and £5,000,000 worth of the Sterling 7.25% Notes due 2008.

63. Defendant Fleet Securities, Inc. ("Fleet") was a co-manager of the 2001 Offering. In connection with that Offering, Fleet sold $15,000,000 worth of the 6.50% Notes due 2004; $40,000,000 worth of the 7.50% Notes due 2011; and $46,000,000 worth of the 8.25% Notes due 2031.

64. Defendant Mizuho International plc ("Mizuho") was a co-manager of the 2001 Offering. In connection with that Offering, Mizuho sold $15,000,000 worth of the 6.50% Notes

due 2004; $40,000,000 worth of the 7.50% Notes due 2011; $46,000,000 worth of the 8.25% Notes due 2031; €12,500,000 worth of the Euro 6.75% Notes due 2008; and £5,000,000 worth of the Sterling 7.25% Notes due 2008.

65. Defendants Salomon, J.P. Morgan, Banc of America, Deutsche Bank, Chase, Lehman Brothers, Blaylock, CSFB, Goldman Sachs, UBS Warburg, ABN/AMRO, Utendahl, Mitsubishi, Westdeutsche, BNP, Caboto, Fleet and Mizuho are collectively referred to herein as the "Underwriter Defendants."

66. It is appropriate to treat defendants Ebbers, Sullivan, Myers and Yates as a group for pleading purposes and to presume that the false and misleading information conveyed in the Company's SEC filings and press releases as alleged herein are the collective actions of this narrowly defined group of defendants. Each of these defendants, by virtue of his high-level position with the Company, directly participated in the day-to-day management of the Company, and was privy to confidential information concerning the Company and its business, operations and accounting results. Each of these defendants was responsible for the Company's accounting practices, and was involved or participated in the drafting, producing and/or disseminating of the false and misleading statements alleged herein.

Related Non-Party

67. WorldCom was the second-largest long-distance telephone company in the United States. During the past five years, WorldCom grew tremendously through acquisitions, using billions of dollars of its stock as the currency for those acquisitions and issuing approximately $23 billion of debt. During the Class Period, WorldCom acquired Sky-Tel Communications on October 1, 1999, in a merger pursuant to which Sky-Tel shareholders received 23 million shares of WorldCom stock in exchange for their stock in Sky-Tel; the Company also acquired Intermedia

Communications, Inc., on July 1, 2001, in a merger in which Intermedia shareholders received 57.1 million shares of WorldCom stock and 2.3 million shares of WorldCom's MCI Tracking stock. The Company issued approximately $17 billion of new debt securities, in the 2000 Offering and the 2001 Offering.

68. It is now clear that this growth by acquisition, and the enormous sale of debt securities, was fueled by overstated financial statements and other fraudulent public statements which had the effect of presenting WorldCom as a profitable company when, in fact, it was losing money and artificially inflating the market prices of its publicly traded securities. On July 21, 2002, WorldCom filed the largest bankruptcy proceeding in U.S. history, and therefore may not be named as a defendant in this Complaint. But for the filing of bankruptcy proceedings, WorldCom would be a defendant in this action.

CLASS ALLEGATIONS

69. Plaintiffs bring this action on their own behalf and as a class action pursuant to Rule 23(a) and Rule 23(b)(3) of the Federal Rules of Civil Procedure on behalf of a class (the "Class") consisting of: all persons and entities who purchased or otherwise acquired publicly traded securities of WorldCom, Inc. during the period beginning April 29, 1999 through and including June 25, 2002, and who were injured thereby, including all persons or entities who acquired shares of WorldCom common stock in the secondary market or in exchange for shares of acquired companies pursuant to a registration statement, and all persons or entities who acquired debt securities of WorldCom in the secondary market or pursuant to a registration statement. Excluded from the Class are: (i) defendants; (ii) members of the family of each individual defendant; (iii) any entity in which any defendant has a controlling interest; (iv) officers and directors of

WorldCom and its subsidiaries and affiliates; and (iv) the legal representatives, heirs, successors or assigns of any such excluded party.

70. Throughout the Class Period, shares of WorldCom common stock were traded actively on the NASDAQ National Market System and WorldCom debt securities were traded on various national and international securities markets, all of which are efficient markets. The members of the Class, as purchasers of the stock and debt securities, are so numerous that joinder of all members is impracticable. While the exact number of Class members may only be determined by appropriate discovery, Plaintiffs believe that Class members number in the hundreds of thousands. There were approximately 2.96 billion shares of WorldCom stock issued and outstanding at times relevant hereto, and approximately $17 billion of debt securities issued by WorldCom, through the Underwriter Defendants, during 2000 and 2001, in addition to the Company's pre-existing debt securities.

71. Plaintiffs' claims are typical of the claims of the members of the Class. Plaintiffs and other members of the Class acquired their WorldCom common stock and/or debt securities pursuant to registration statements or on the open market, and sustained damages as a result of defendants' wrongful conduct complained of herein.

72. Plaintiffs will fairly and adequately protect the interests of the other members of the Class and have retained counsel competent and experienced in class action securities litigation.

73. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Because the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for Class members individually to seek redress for the wrongful conduct alleged herein.

74. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

(a) Whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) Whether the registration statements issued by WorldCom contained material misstatements or omitted to state material information;

(c) Whether WorldCom's financial results during the Class Period were materially misstated;

(d) Whether Andersen's unqualified reports issued on WorldCom's financial statements during the Class Period materially misstated that Andersen's audits thereon were conducted in accordance with GAAS and/or in accordance with standards established by the American Institute of Certified Public Accountants ("AICPA");

(e) Whether the analyst reports authored and disseminated by Grubman and Salomon regarding WorldCom were materially false and misleading;

(f) With respect to the claims arising under § 10(b) of the Exchange Act, whether defendants named in those claims acted with scienter;

(g) Whether the market prices of WorldCom publicly traded securities during the Class Period were artificially inflated due to the material omissions and misrepresentations complained of herein; and

(h) Whether the members of the Class have sustained damages and, if so, the appropriate measure thereof.

75. Plaintiffs know of no difficulty that will be encountered in the management of this action that would preclude its maintenance as a class action.

76. The names and addresses of the record owners of WorldCom publicly traded securities, purchased or acquired during the Class Period, are available from the Company's transfer agent(s) and/or from the Underwriter Defendants. Notice may be provided to such record owners via first class mail using techniques and a form of notice similar to those customarily used in class actions.

THE BASIS OF THE CLAIMS

77. The allegations in this Complaint are made upon knowledge with respect to the actions of the NYSCRF and the other Plaintiffs, and upon other facts obtained through an investigation conducted by the NYSCRF's undersigned counsel, which included, among other things, reviews of public filings with the SEC by WorldCom, its predecessors and certain of the individual defendants; press releases; publicly available trading information; articles in the general press, the financial press, on wire services and in publications in the accounting field; analyst reports; documents identified in SEC filings and to various investigative entities; charging instruments in criminal proceedings related to WorldCom; complaints filed by the SEC and the Attorney General of the State of New York; interviews of witnesses; review of documents provided by witnesses and others; and publicly available information concerning WorldCom and certain of the defendants.

78. The NYSCRF's investigation of this action is continuing. WorldCom has stated that it will be supplementing its previously disclosed restatements of past financial statements. Reports in the press have stated that the Examiner appointed by the Bankruptcy Court, a former United States Attorney General, will be issuing a preliminary report in early November 2002. A law firm

retained to conduct an internal investigation of the fraud at WorldCom is preparing a report for the WorldCom Audit Committee and filing with the SEC. The United States Attorney for this District is pursuing its criminal investigation of the fraud at WorldCom, has already obtained one indictment and several guilty pleas, and has indicated that he may be adding new charges and additional defendants in the near future. In addition, there are continuing investigations by various committees of the United States Congress, the New York Stock Exchange, the National Association of Securities Dealers, and others, which are likely to bring further information relevant to the claims in this Complaint to light.

79. The NYSCRF reserves the right to amend this Complaint, in accordance with the Federal Rules of Civil Procedure and controlling cases, if and when further information relevant to the claims in this Complaint, or potential claims against others not named in this Complaint, is obtained.

SUBSTANTIVE ALLEGATIONS

The Growth of WorldCom Begins to Slow

80. For many years before the start of the Class Period, WorldCom and its CEO, Ebbers, pursued a strategy of growth by acquisition. By 1998, WorldCom had acquired more than sixty companies in transactions valued at more than $70 billion, in the process becoming the second largest telecommunications company in the world, behind only AT&T. For example, in January 1996, WorldCom acquired MFS Communications Company, Inc. for $12.5 billion in stock. In 1998, WorldCom acquired a large local access provider, Brooks Fiber Properties, Inc., for approximately $1.2 billion in stock, and CompuServe Corp., a leading Internet service provider, for $1.3 billion in stock.

81. The biggest such deal occurred on September 14, 1998, when WorldCom acquired MCI in a transaction valued at $40 billion and, in the process, became the world's second largest telecommunications company. In the press release announcing the merger, Ebbers proclaimed that "MCI WorldCom is out in front and sets the standard by which all other communications companies will be measured."

82. These acquisitions served two purposes. First, although by 1999 the fundamentals of the telecommunications industry were beginning to deteriorate due to intense competition among providers, the acquisitions enabled WorldCom to report increasing revenues and earnings per share and effectively disguise the problems in its business. Second, as reported by The New York Times on August 8, 2002, WorldCom's acquisition binge allowed the Company to manipulate its financial results.

83. With each acquisition, WorldCom would take charges of millions, or even billions, of dollars to account for costs supposedly incurred in connection with the merger. Such enormous charges were typical in the 1990's when companies acquired one another, and WorldCom and its senior officers knew that Wall Street would not be concerned with the size of the charges. However, WorldCom would include in the charge the cost of the acquired company's expenses expected in future quarters. This meant that WorldCom would not have to record these expenses in the periods in which they were actually incurred, and allowed the Company to report earnings that were materially inflated.

84. In addition, WorldCom took charges, as merger reserves, that were significantly larger than the amounts for which such reserves were actually needed. WorldCom would then "tap" into this reserve fund whenever it needed a boost in earnings. As one former WorldCom

executive said, "[t]he boost from post-acquisition accounting was like a drug. But it meant bigger deals had to come along to keep the ball rolling."

85. Turning to the MCI merger, WorldCom used that acquisition as an opportunity to raise its reported future earnings through manipulative accounting. For example, WorldCom reduced the book value of MCI's hard assets by $3.4 billion, and simultaneously increased goodwill, the value of intangible assets, by the same amount. Under GAAP, had the fair value of the assets WorldCom acquired been equal to MCI's book value, WorldCom would have had to charge off the entire amount against earnings over slightly more than four years. But goodwill could be amortized over approximately forty years, far more time than hard assets. So, with WorldCom's creative accounting, shifting the $3.4 billion into goodwill meant that the Company was able to record those expenses over decades rather than a few years, thus reducing earnings in the near term by far smaller increments.

WorldCom Turns to Outright Fraud

86. With various reserves established by the end of 1998, the stage was set for the most astounding fraud in U.S. corporate history. As WorldCom has admitted, the Company manipulated its earnings reports as early as 1999, when it overstated its pretax income by $209 million and EBITDA by $217 million. However, its 1999 manipulations were only a prelude to far greater overstatements that the Company's senior management directed after its growth by acquisition strategy began to stall.

87. In October 1999, WorldCom announced that it had agreed to acquire Sprint in a stock-for-stock transaction valued at a staggering $129 billion. However, despite heavy lobbying by Ebbers and other WorldCom executives, in June 2000 the Justice Department refused to approve

the merger, on the grounds that the combination threatened competition in the telecommunications industry.

88. Moreover, beginning in early 2000, as the Sprint deal collapsed, WorldCom's revenues began to decline, and its costs, as a percentage of revenue, began to materially increase. Anticipating huge growth in telecommunications services, WorldCom had in earlier years entered into a number of long-term lease agreements with various telecommunications carriers to gain the right to use their networks to serve customers who were not directly connected to WorldCom's own network. Many of these leases required WorldCom to make fixed monthly payments to the carrier over the full term of the lease, regardless of whether WorldCom actually used the leased facilities. These costs are referred to as "line costs," which, simply stated, are the fees that WorldCom pays local telephone companies to carry the calls of WorldCom's customers. Under GAAP, these fees must be reported as an expense on a company's income statement. Prior to 2000, these payments, which constituted WorldCom's single biggest operating expense, had always been accounted for at WorldCom as expenses, and reported as a separate line item on its income statements as part of WorldCom's operating expenses.

89. However, as detailed in a civil complaint filed by the SEC against Myers on September 26, 2002, by no later than July 2000, WorldCom's senior officers were well aware that WorldCom's revenues were falling precipitously and that this decline "created a substantial risk that WorldCom's publicly reported income would fail to meet the expectations of Wall Street analysts." WorldCom's management also knew that, if the Company failed to meet expectations, it would have a disastrous impact on the price of WorldCom's stock and publicly traded debt. Thus, beginning no later than 2000, WorldCom engaged in a series of fraudulent accounting

manipulations designed to inflate artificially WorldCom's publicly reported income by falsely reducing its line cost expenses in at least two ways.

90. First, WorldCom improperly released certain reserves held against operating expenses to reduce its line cost expenses. Specifically, at least by October 2000, at the direction of WorldCom senior management, WorldCom employees made fraudulent and false entries in the Company's general ledger reducing its line cost expenses and then, in amounts corresponding to the fraudulent and false line cost expense amounts, reduced various reserve accounts. Prior to filing its complaint against Myers, the SEC determined that there was neither any documentation to support these entries, nor any proper business rationale for them, and that they violated GAAP.

91. The Indictment recently filed against former WorldCom CFO Sullivan and former WorldCom Director of General Accounting Yates describes the foregoing circumstances in detail. According to testimony and/or documents presented to the grand jury that returned the Indictment:

(a) In or about October 2000, after reviewing preliminary financial statements for the third quarter of 2000, Sullivan and other WorldCom executives determined that WorldCom's expenses as a percentage of revenue were too high to meet analysts' expectations and were substantially higher than management's previous "guidance" to professional securities analysts and members of the investing public.

(b) To meet analysts' expectations, Sullivan instructed Myers, Yates, and two members of WorldCom's accounting department, Betty Vinson and Troy Normand, to fraudulently book certain entries in WorldCom's general ledger, which were designed to reduce WorldCom's reported line costs and thereby increase WorldCom's reported earnings.

(c) Specifically, Sullivan instructed Myers, Yates, Vinson, and Normand to make journal entries crediting line cost expense accounts. To make these entries balance on

WorldCom's general ledger, Sullivan instructed Myers and the others to debit, in amounts corresponding to the line cost credits, various reserve accounts on WorldCom's balance sheet, such as accrued line costs, deferred tax liability, and other long-term liabilities.

(d) Neither Sullivan nor Myers provided Yates, Vinson, or Normand with any supporting documentation or any proper business rationale for the entries. Nevertheless, Yates, Vinson, Normand, and others booked certain entries in WorldCom's general ledger, which had the net effect of reducing line costs by approximately $828 million, and thereby increasing WorldCom's publicly reported earnings for the third quarter of 2000 by the same amount.

(e) Sullivan, Myers, Yates, Vinson, and Normand knew that there was no justification in fact or under GAAP for these entries.

Indictment ¶21.

92. The Indictment alleges that Sullivan, Myers and others engaged in the same course of conduct in early 2001, after ascertaining that WorldCom's financial results for the fourth quarter of 2000 would "miss" Wall Street's expectations. Indictment ¶22.

93. Through these fraudulent acts, WorldCom reduced its reported line cost expenses during the third and fourth quarters of 2000 by $828 million and $407 million, respectively -- a total of $1.235 billion -- and therefore reported pretax income inflated by those same amounts for those periods.

94. The scheme continued into 2001. In or around April 2001, WorldCom's senior management determined that the Company could not continue to draw down its reserves to offset line costs. Accordingly, WorldCom changed its method of fraudulently inflating income. At Sullivan's direction, Myers and other WorldCom employees fraudulently reclassified line cost

expenses to WorldCom's capital expense accounts, again without any supporting documentation or legitimate business rationale. Through this second, albeit related, fraudulent scheme, WorldCom improperly capitalized line costs for the next five quarters, from the first quarter of 2001 through the first quarter of 2002. Thus, rather than being recorded as expenses, which would have an immediate negative impact on WorldCom's reported profits, 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. This had the effect of inflating WorldCom's earnings, total assets, and net worth. Once again, to account for line costs in this fashion was a blatant and egregious violation of GAAP. Under GAAP, line costs, which do not generate value in future years but, rather, are ongoing expenses, cannot be capitalized. Indeed, as one KPMG partner who reviewed WorldCom's accounting manipulations stated, this accounting issue is "an open and shut case."

95. Again, the Indictment describes these fraudulent acts in detail. According to testimony and/or documents presented to the grand jury that returned the Indictment:

(a) In or about April 2001, after reviewing WorldCom's preliminary financial statements for the first quarter of 2001, Sullivan and other WorldCom executives again determined that WorldCom's expenses as a percentage of revenue were too high to meet analysts' expectations. Sullivan, Myers, and Yates agreed that it was no longer possible to disguise WorldCom's rising ratio of expenses to revenue by reducing various reserves on WorldCom's general ledger.

(b) Sullivan, Myers, and Yates therefore discussed a scheme to hide WorldCom's increasing expenses by causing substantial portions of WorldCom's line costs to be transferred from current expense accounts into capital expenditure accounts. This

transfer would allow WorldCom to defer recognizing a substantial portion of its current operating expenses, thereby allowing WorldCom to report higher earnings.

(c) To implement this scheme, Sullivan instructed Myers to direct employees of WorldCom's general accounting department to make various journal entries necessary to transfer certain line costs from expense accounts on WorldCom's general ledger to capital expenditure accounts on WorldCom's general ledger.

(d) In furtherance of this plan, Sullivan and Myers instructed certain subordinates, including Yates, Vinson, and Normand, to make journal entries transferring certain line costs from expense accounts in WorldCom's general ledger to certain general ledger accounts for capital expenditures.

(e) As a result of these transfers, billions of dollars of WorldCom's current expenses were transferred from expenses on its income statement to assets on its balance sheet. Contrary to WorldCom's usual practices and prevailing accounting industry norms, no documentary support existed for any of these entries, which reclassified certain line costs as capital expenditures.

Indictment ¶¶23-25.

96. Documents produced to Congress in connection with its investigation also show that the fraud was intentional and deliberate. One of those documents is an e-mail dated June 26, 2002, from a WorldCom executive named Steven Brabbs to WorldCom's internal auditors that recounted certain events that took place in 2000. In that e-mail Brabbs explained that:

(a) In March of 2000, Brabbs notified WorldCom executives and Andersen that the Company was fraudulently accounting for line cost expenses, but the transactions remained on the Company's books until the restatement. Brabbs was WorldCom's Director

- International Finance & Control in March 2000, and his responsibilities included providing the consolidated accounting numbers for Europe and Asia to WorldCom management in the United States. According to the email, after WorldCom's International Division had closed its books and reported its results for the first quarter of 2000, a journal entry was made which reduced the International Division's line cost expenses by $33.6 million. Brabbs was disturbed by the change and did not know why it had occurred. After making a series of phone calls and emails to the United States from his London office, "we were told that the entry had been made on the basis of a directive from Scott Sullivan. Despite repeated requests, we were given no support or explanation for the entry."

(b) During April 2000, Brabbs reviewed at a "high level" the International Division's first quarter results with Andersen's audit partner in the United Kingdom, as well as the senior manager. Brabbs noted that the increase in the margin trend was "obvious" and told the auditors that they should "request follow through in the United States to ensure appropriate accounting treatment was in place at the global consolidated level." A relevant paragraph about this transfer was included in the report that Andersen U.K. sent to both Andersen and WorldCom executives.

(c) Shortly afterwards, Brabbs received an email from Myers, who expressed anger at him for raising this issue with Andersen. Brabbs responded by saying that "we had no support for it in International, and that it was appropriate therefore to request justification (or alternatively a corresponding and reversing entry) from the U.S."

(d) The next quarter (that is, the second quarter of 2000), senior finance executives in the United States told Brabbs they wanted to "push down" the fraudulent entry so that it would appear in International's accounting records and not in the records of the

accounting department of the Company's headquarters in the United States. Brabbs refused, noting that he had no supporting documentation, and thus no basis, to make the adjustment. However, Brabbs was instructed by Sullivan to make the entry. Still uncomfortable, Brabbs tried to keep the International Division's books clean by establishing a fictitious entity with no legal existence, and placing the costs on the books of that sham company. Once again, these facts were known to WorldCom senior management, including Sullivan. According to Brabbs:

> However, pressure was exerted and we were instructed to make the entry (the pressure we understood was from Scott's office specifically). Still uncomfortable, I said that I would not under any circumstances book the journal into one of our legal accounting company books and records. What we agreed to do was create a "management company" (NOT a legal entity) and post it there. 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 that I could support from a legal or US or local accounting perspective. This entry was made on 10 July 2000. The narrative reads "late adj as instructed by Scott Sullivan." It remains there today.

(e) Brabbs continued to raise the subject by phone and email during the latter half of 2000. However, each time he did, WorldCom's senior finance management refused to discuss it, and simply continued to refer back to the fact that the entry had been made at Sullivan's instruction.

97. Other documents also show that WorldCom's senior finance and accounting employees knew that capitalizing line costs was improper. In a series of emails that began on July 19, 2000, Tony Minert, the telecommunications reporting manager, wrote to Myers and Yates, noting that increasing amounts of line capacity often went unused, although that capacity had already been paid for. Minert asked Myers and Yates if the costs of that "prepaid capacity" could

be capitalized as an asset. "The impact," Minert wrote, "could be huge." Minert's suggestion was initially rejected. On July 25, 2000, Yates wrote Minert that "David [Myers] and I have reviewed and discussed your logic of capitalizing excess capacity and can find no support within the current accounting guidelines that would allow for this accounting treatment."

98. When it came time to report results for the third quarter of 2000, however, WorldCom's senior executives changed their tune. They realized that, because of declining revenues, the Company would not be able to meet analysts' earnings expectations. Accordingly, as recounted above, they proceeded to "cook the books" by improperly capitalizing line cost expenses, thereby simply eliminating billions of dollars in expenses. At the end of the third quarter of 2000, Normand went to Sullivan to express his concerns about the improper capitalization of line cost expenses. Sullivan told him that there were "business reasons" for the entries, explained that "some things were occurring to him to bring the cost structure down," and assured him that "everything would be ok."

99. Other documents, as well as facts uncovered by Congress and by WorldCom's internal investigation, demonstrate that Ebbers was directly implicated in the fraud:

(a) The House Committee on Financial Services has stated that its staff was told by WorldCom's general counsel that Sullivan had told Ebbers about "hundreds of millions of dollars" that were transferred into capital expenditures accounts.

(b) On March 5, 2001, Myers sent an email to a WorldCom employee, Tom Bosley, and Sullivan, which "reminded" Bosley that, at a dinner with Sullivan and Ebbers before the Company announced its results for the fourth quarter of 2000, Bosley had "volunteered to do whatever necessary" to get margins back in line. According to the email:

> Scott relayed a conversation you had with him at dinner when your [sic] volunteered to do whatever necessary to get

> Telco/Margins back in line. This was a dinner with Scott, Ron [Beaumont, WorldCom's Chief Operating Officer] and Bernie [Ebbers] prior to the announcement of our last quarter.
>
> As you can see, margins have declined significantly and your immediate attention is appreciated. We need to address this during the quarter and not at the end of the quarter. Just so you know, I fully realize the impact that decling [sic, declining] pricing to our customers has had on margins but I hope you feel like me that it is impossible to accept declining margins . . . .

(c) On March 6, 2001, Bosley replied to Myers in an email as follows:

> Actually I asked Scott [Sullivan] what numbers he wanted and I would see what could be done to get them. But . . . obviously gross margin is very important and we will put several projects in place to get this moving back where it was. The first quarter is pretty well cast at this point but we will define what we can do to reverse the trend.

Myers forwarded the email to Sullivan, and later that day, Sullivan emailed Myers that "the numbers are in your attached spreadsheet and he needs to get to work now."

100. Through the fraudulent conduct described in ¶¶ 86-99 above, WorldCom fraudulently transferred more than $3.85 billion in line cost expenses to its capital accounts: $3.055 billion in 2001, and $797 million in the first quarter of 2002. Had the Company properly accounted for these expenses, earnings would have been considerably different than reported and far below Wall Street expectations.

101. Together, these two prongs of the scheme -- the drawdowns from reserves (¶¶ 90-93) and the capitalization of operating expenses (¶¶ 94-99) -- had immense impact on the financial figures disseminated to the investing public. In 2000, WorldCom reported pretax earnings of $1.6 billion, when in reality the Company had a profit of less than one-fourth that amount, only $365 million. The impact of the fraud was even more pronounced in 2001, as WorldCom reported line costs of $14.7 billion and pretax earnings of $2.4 billion, when in reality line costs were $17.8

billion, and the Company should have reported a loss of $662 million for the year. Similarly, in the first quarter of 2002, the Company reported pretax income of $240 million when the Company actually suffered a loss of at least $557 million. Quite simply, through this fraud, WorldCom turned what were massive losses into what appeared to be profits sufficient to meet or exceed Wall Street's expectations.

An Internal Audit Sounds the Whistle

102. According to numerous press reports and internal WorldCom documents that were produced to Congress during May 2002, Cynthia Cooper, WorldCom Vice President - Internal Audit, began an investigation of certain of the Company's capital expenditures and capital accounts. The audit had been scheduled for third quarter of 2002, but Cooper advanced it. Cooper quickly determined that a number of large, questionable transfers had been made from operating expenses into the Company's capital accounts during 2001 and the first quarter of 2002. Cooper discussed her investigation with Sullivan on June 11, 2002, and Sullivan asked her to delay her review until the third quarter. Sullivan also sought to minimize the problem, falsely telling Cooper that the capitalizing of line costs started in the third quarter of 2001, and that these issues would be "corrected" in the 2002 second quarter. Cooper, however, continued her investigation.

103. On June 17, 2002, Cooper met with, among others, a number of WorldCom employees involved in the fraud, including Myers, Yates and Vinson. Cooper asked Vinson, who was WorldCom's Director of Management Reporting, for support for the transfers. Vinson stated that she "posted the prepaid capacity entries but did not know what prepaid capacity was and did not have support for the entries." Vinson also indicated that Myers and Yates provided the amounts for the entries and told Cooper she should ask them for the support. Accordingly, Cooper asked Yates for support for the entries. Yates told her that "he was not familiar with the entries and that

we should talk to David Myers." Yates also indicated that he, too, had never heard of prepaid capacity. Thus, according to a memo that Coopers wrote which recounted the conversation:

> Next we went to David Myers' office and requested support for the entries. David stated that he did not have support for the entries and that the amounts were booked based on what they thought the margins should be. David said that there were no accounting pronouncements to support these entries. David acknowledged that line costs should probably not have been capitalized and stated that it was difficult to stop once started.

104. As previously noted, WorldCom issued a press release on June 25, 2002 announcing that an internal audit had uncovered approximately $3.8 billion in improperly reported earnings and that the Company would restate its financial statements for 2001 and the first quarter of 2002. The Company admitted that "certain transfers from line cost expenses to capital accounts during the period were not made in accordance with generally accepted accounting principles." The release indicated that the fraudulent transfers totaled $3.055 billion for 2001 and $797 million for the first quarter of 2002. In that same announcement, the Company announced that it had fired Sullivan and had accepted the resignation of Myers, and that Andersen had advised WorldCom that its audit report on the Company's 2001 financial statements and its review of the Company's first quarter 2002 financial statements could not be relied upon.

Post June 25, 2002 Events

105. The reaction to this stunning announcement -- the largest restatement in history -- was swift. On the very next day, June 26, 2002, the SEC filed a complaint against WorldCom accusing it of fraud. On June 27, 2002, the House Committee on Financial Services announced that it would hold hearings relating to the WorldCom fiasco beginning on July 8. Almost immediately, that Committee and the House Committee on Energy and Commerce issued subpoenas to WorldCom executives, Andersen and Salomon.

106. On July 8, 2002, Ebbers and Sullivan both refused to answer questions posed by the House Committee on Financial Services, invoking the Fifth Amendment. Melvin Dick, the engagement partner at Andersen responsible for the WorldCom audit for the year 2001, claimed that, prior to June 2002, neither he nor any member of the Andersen team "had any inkling that these transfers had been made." (Less than one week later, Congress released the email that had been sent by Brabbs (see ¶ 96 above), which noted that Andersen had been informed in April 2000 that WorldCom was fraudulently transferring line costs. As noted by The Wall Street Journal and others, the Brabbs email directly contradicted Dick's testimony.)

107. On July 8, 2002, WorldCom filed with the SEC its Revised Statement Pursuant to Section 21(a)(1) of the Securities Exchange of 1934 (the “Revised Statement”). In the Revised Statement, WorldCom admitted that certain line cost expenses were transferred to capital accounts in violation of GAAP. The Revised Statement provided a quarterly breakdown of the improper capitalization of line costs: $771 million for the first quarter of 2001; $610 million for the second quarter of 2001; $743 million for the third quarter of 2001; $931 million for the fourth quarter of 2001; and $797 million for the first quarter of 2002. The Company revealed $217 million of improper earnings in 1999, an additional $2.864 billion of improper earnings in 2000, an additional $161 million of improper earnings in 2001, and an additional $88 million of improper earnings in 2002.

108. On July 31, 2002, in this District, Magistrate Judge James C. Francis IV was presented with the Criminal Complaint, which contained the sworn statement of an FBI agent who summarized facts uncovered to that point regarding the WorldCom fraud. Upon reviewing that affidavit (which is incorporated herein by reference), Magistrate Judge Francis determined that there was probable cause to conclude that a criminal conspiracy to commit securities fraud had

existed at WorldCom; accordingly, he signed warrants for the arrest of two of the alleged co-conspirators, Sullivan and Myers. Both men were arrested and arraigned the following day.

109. On August 28, 2002, Sullivan was indicted on conspiracy, securities fraud, and false filing charges. Yates was also charged as a defendant and co-conspirator in the Indictment. Myers, Vinson and Normand were named as unindicted co-conspirators.

110. On September 26, 2002, Myers pled guilty to a three-count criminal Information charging conspiracy, securities fraud and making false filings with the SEC. On October 7, 2002, Yates became the second WorldCom executive to plead guilty to conspiracy and securities fraud, admitting that he followed Sullivan's instructions to falsify expenses and that these accounting manipulations had "no justification" other than to inflate WorldCom's earnings and deceive investors. And on October 10, 2000, two additional WorldCom employees – Vinson and Normand – entered guilty pleas to charges of securities fraud and conspiracy to commit securities fraud.

WORLDCOM'S FALSE AND MISLEADING STATEMENTS

111. The Company's financial results for 1999, 2000, 2001, and the first quarter of 2002 were artificially inflated by a host of improper accounting practices including, among other things, improper capitalization of expenses, excessive acquisition write-offs, improper revenue recognition, and improper accounting for goodwill. As described below, WorldCom's financial results for each quarter during the Class Period falsely reported, among other things, revenues, earnings, pretax income, expenses, assets, and net worth.

False and Misleading Statements Relating to the 1999 First Quarter

112. On April 29, 1999, World Com issued a press release reporting its financial results for the quarter ended March 31, 1999 (the "1Q 1999 Press Release"). Net income for the first quarter of 1999 was $709 million, or $0.37 per common share. Operating income for the quarter

was $1.45 billion, up 241% (on a reported basis) and 140% (on a pro forma basis) from the first quarter of 1998. Commenting on these "impressive" results, Ebbers stated:

> This is an excellent start to the year and is indicative of how well the merger with MCI has progressed . . . Our margin improvement and earnings performance are particularly impressive this early in the year. The divestiture of virtually all of our non-core assets has provided us with financial flexibility to further increase our capital investment in certain high growth areas – particularly for Internet, local and international services.
>
> We believe this incremental capital spending combined with more aggressive selling and marketing efforts will continue to propel strong top-line sales growth in our core communications services for the foreseeable future.

113. Influential Wall Street analysts commented favorably on the statements regarding WorldCom's first quarter 1999 results, and, in particular, the Company's growth levels. On April 29, 1999, Grubman trumpeted the fact that the Company's quarterly "EPS results were $0.02 above Street consensus and $0.03 above our estimate" and stated that the quarter was distinguished by "very strong top-line growth."

114. On May 17, 1999, WorldCom filed its Form 10-Q for the quarter ending March 31, 1999 (the "1Q 1999 Form 10-Q") with the SEC, which was signed by Sullivan. The 1Q 1999 Form 10-Q reiterated the consolidated financial results reported in the 1Q 1999 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

115. The statements referenced in ¶¶ 112 and 114 above relating to WorldCom's first quarter 1999 results were each false and materially misleading because, as described above, the Company's financial results reported materially overstated revenues, earnings, pretax income, assets and net worth, and materially understated expenses, in violation of GAAP.

False and Misleading Statements Relating to the 1999 Second Quarter

116. On July 29, 1999, WorldCom issued a press release announcing its financial results for the quarter ended June 30, 1999 (the "2Q 1999 Press Release"), including net income of $863 million, or $0.45 per common share. Commenting on the results, Ebbers stated:

> The Company continues to execute on or ahead of plan with respect to merger synergies and the diversification of revenues . . . Our communications services revenue growth is being driven by continued strong top line performance in data, Internet and international – three of the fastest growing and most profitable areas within communications services.
>
> More impressive though, was the strong pace of improvement in our earnings, margins and cash flow. Our rapidly improving profitability, combined with recent divestitures of non-core assets, has provided the financial flexibility to pursue other high growth communications services opportunities . . . .

117. Analysts highlighted the statements regarding WorldCom's "impressive" results and, in particular, the representations regarding earnings and margins. For example, Grubman wrote on July 30, 1999 that "the quality of WCOM earnings was very high . . . [t]he quarter was highlighted by double-digit revenue growth and impressive margin expansion. . . ."

118. On August 16, 1999, WorldCom filed its Form 10-Q for the quarter ending June 30, 1999 (the "2Q 1999 Form 10-Q") with the SEC, which was signed by Sullivan. The 2Q 1999 Form 10-Q reiterated the consolidated financial results reported in the 2Q 1999 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

119. The statements referenced in ¶¶ 116 and 118 above relating to WorldCom's second quarter 1999 results were each false and materially misleading because, as described above, the

Company's financial results reported materially overstated revenues, earnings, pretax income, assets and net worth, and materially understated expenses, in violation of GAAP.

False and Misleading Statements Relating to the 1999 Third Quarter

120. On October 28, 1999, WorldCom issued a press release announcing its financial results for the quarter ended September 30, 1999 (the "3Q 1999 Press Release"), including net income, after goodwill amortization, of $1.1 billion, or $0.56 per common share. Commenting on these results, Ebbers stated:

> We continue to anticipate and respond to rapid change in our industry -- technology advances, regulatory change and most significantly customer expectations . . . Through innovative marketing and an unwavering focus on quality and cost controls we continue to deliver products and services to our growing customer base, which are both feature-rich and competitively priced. This winning formula, once again, drove impressive gains in revenues and earnings.

121. On November 15, 1999, WorldCom filed its Form 10-Q for the quarter ending September 30, 1999 (the "3Q 1999 Form 10-Q") with the SEC, which was signed by Sullivan. The 3Q 1999 Form 10-Q reiterated the consolidated financial results reported in the 3Q 1999 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

122. The statements referenced in the above paragraphs relating to WorldCom's third quarter 1999 results were each false and materially misleading because, as described above, the Company's financial results reported materially overstated revenues, earnings, pretax income, assets and net worth, and materially understated expenses, in violation of GAAP.

False and Misleading Statements Relating to the 1999 Fourth Quarter and Year

123. On February 10, 2000, WorldCom issued a press release announcing its financial results for the quarter and full year ended December 31, 1999 (the "Full Year 1999 Press Release"). The Full Year 1999 Press Release reported WorldCom's earnings as follows:

> [E]arnings before goodwill amortization ("cash earnings") [were] $1.6 billion, or $0.54 per common share. Reported net income, after goodwill amortization, was $1.3 billion, or $0.44 per share. Reported net income, excluding net gain items of $112 million before tax, $64 million after tax or $0.02 per share, was $1.2 billion, or $0.42 per common share.
>
> On a full year basis, cash earnings were $5.1 billion or $1.75 per common share. Reported net income, after goodwill amortization, was $3.9 billion, or $1.35 per common share. Reported net income, excluding net gain items of $87 million after tax, or $0.03 per share, was $3.9 billion, or $1.32 per common share.

124. In the press release, Ebbers called the financial results "outstanding" and noted that WorldCom's "industry leading incremental revenue gains" and "industry leading earnings growth" set the Company apart from its competitors:

> Our achievements in the quarter and full year 1999 were outstanding given the dramatic changes impacting communications services . . . . On an annualized basis, data, Internet and international services represent $14 billion of revenues growing at 36 percent year-over-year. Our proven ability to deliver this type of revenue growth, along with industry leading earnings growth is our mark of distinction.

125. The Company's press release further discussed the supposed financial improvement in WorldCom's business as a result of the WorldCom/MCI merger, stating:

> The improvement in operating income is due to the realization of merger synergies, a focus on -- and improving mix of -- higher margin revenues. Gross margin dollars continued to expand, growing faster than revenue growth, up 22 percent for the quarter -- underscoring the quality of the earnings improvement.

126. Later in the Full Year 1999 Press Release, Ebbers touted the Company's "impressive" 1999 financial results and predicted "further revenue growth":

> Our accomplishments in 1999 are impressive. In addition to leading our sector in incremental revenue gains and expanding profitability on those revenues, we substantially strengthened our business through acquisitions and divestitures.
>
> The investments in 1999 will provide revenue growth and wireless data capabilities that will become increasingly more important as the Internet goes mobile. The early successes we have achieved in Internet and data services, coupled with the corresponding capital investments have positioned us to lead the industry in the transition to an "all-distance" advanced communications services platform. With more than $12 billion of annualized revenues and approximately $3 billion of incremental revenues coming from data and Internet today, we have confidence in our ability to lead the industry in this transition, and a track record of accomplishing it profitably.

127. Also on February 10, 2000, WorldCom hosted a conference call for the investing community and analysts. Ebbers opened the call by announcing that 1999 was an "outstanding performance year." Ebbers attributed the Company's reported success in large measure to the MCI merger, stating:

> Our most important success in 1999 has been the MCI integration. For five quarters we've delivered the synergies ahead of schedule. EBITDA margins improved by 52% to 35.5% of revenues and added $2.6 billion of net income in 1999. Cash earnings grew to $5.1 billion or $1.73 per share, and we accomplished that exceptional growth in profitability while adding nearly $4.7 billion of incremental revenue. I'm proud of how former MCI and WorldCom employees have worked together to accomplish so much, it hasn't always been easy. Our success with the MCI integration should give you comfort with the Sprint transaction. We know how to put companies together and get the most out of them.

128. Sullivan also spoke on the February 10, 2000 conference call, remarking on the Company's 1999 performance and highlighting the fact that the Company had met analysts' earnings targets for the year:

> I have three quick points to make and one message to deliver. First, we earned a solid 42 cents from operations in the fourth quarter. Second, we produced solid double-digit revenue growth in the fourth quarter. Third, we delivered $2.7 billion in first year synergies with the combination of MCI and WorldCom. And that leads up to my one message. Based upon where we exited 1999 we feel every bit of confidence for 2000 analysts' expectations, top to bottom. This was another solid quarter for MCI WorldCom. The Company posted another quarter of increased profitability resulting from effective merger synergy execution as well as strong double-digit revenue gains.
>
> As Bernie [Ebbers] said, we had a busy year in 1999. It was a year of significant accomplishments. We integrated MCI and WorldCom. We delivered on our synergy plan. We delivered on our operating plan . . . . <u>On top of all the accomplishments, we delivered on the day-to-day business and our earnings targets</u>. (Emphasis added).
>
> . . . The fundamentals of our business remain strong. Fourth quarter net income nearly tripled compared to fourth quarter of 1998, while operating income more than doubled. EBITDA margins expressed as a percentage of revenues jumped over 11 percentage points during the period to over 37%. Clearly the synergy and growth opportunities presented in our business combinations are driving these improvements. Our results highlight the importance of having an industry-leading cost structure, especially in a rapidly changing marketplace. Given the competitive pricing environment in both the consumer and business markets, we not only competed effectively, we posted $1.2 billion of incremental quarterly revenues . . . and we significantly increased our profitability and the quality of our earnings.

129. Ebbers ended the February 10, 2000 conference call by stating: "I hope you can sense the energy and the confidence we enter the year 2000 with. With the best employee base in the industry, we will achieve the results expected of us."

130. The statements referenced in the above paragraphs relating to WorldCom's fourth quarter 1999 results were each false and materially misleading because, as described above, the Company's financial results reported materially overstated revenues, earnings, pretax income, assets and net worth, and materially understated expenses, in violation of GAAP.

131. Financial analysts noted immediately that WorldCom's reported quarterly results were in line with consensus expectations. On February 15, 2000, Grubman reported that WorldCom's revenues were "exactly in line with our . . . estimate" and called the Company's margin profile "extraordinary." Grubman attributed WorldCom's success to "several acquisitions that have helped the company to [attain] its predominant position in the telecom world."

132. On March 30, 2000, WorldCom filed its Form 10-K for the year-ended December 31, 1999 (the "1999 Form 10-K"), which was signed by defendants Alexander, Allen, Areen, Aycock, Bobbitt, Ebbers, Galesi, Kellett, Macklin, Roberts, Sidgmore, Sullivan and Tucker, and which reiterated the materially false and misleading financial information initially disclosed in the February 10, 2000 press release and conference call.

133. The 1999 Form 10-K also contained a clean audit opinion by Andersen, addressed to the shareholders of WorldCom, which represented that:

> We have audited the accompanying consolidated balance sheets of MCI WORLDCOM, Inc. (a Georgia corporation) and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, shareholders' investment and cash flows for each of the years in the three-year period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Brooks Fiber Properties, Inc., a company acquired during 1998 in a transaction accounted for as a pooling-of-interests, as discussed in Note 2, as of and for the year ended December 31, 1997. Such statements are included in the consolidated financial statements of MCI WORLDCOM, Inc. and reflect total revenues of two percent of the related consolidated totals in 1997. These statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to amounts included for Brooks Fiber Properties, Inc. is based solely upon the report of the other auditors.
>
> We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about

> whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.
>
> In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of MCI WORLDCOM, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.

134. Andersen's statements in the above paragraph relating to the 1999 audit were false and materially misleading because Andersen had not conducted its audit in accordance with GAAS and, further, because WorldCom's financial statements were not in conformity with GAAP.

False and Misleading Statements Relating to the 2000 First Quarter

135. On April 27, 2000, WorldCom issued a press release announcing its financial results for the quarter ended March 31, 2000 (the "1Q 2000 Press Release"). The 1Q 2000 Press Release reported "strong profitability gains in first quarter 2000 driven by robust data, Internet and international revenues and declining access and technology costs," including net income of $1.3 billion, or $0.44 per common share, for the quarter – an 80% year-over-year increase. Commenting on these results, Ebbers stated:

> WorldCom continues to enjoy success in its focus markets. On an annualized basis, data, Internet and international services represent more than $18 billion of annualized revenues growing at 32 percent . . . We are clearly leading the communications industry into a new era . . . .

136. Once again, the Street reacted favorably to the statements regarding the Company's financial results for first quarter 2000. On April 27, 2000, Grubman noted in a report published by Salomon that WorldCom's quarterly earnings per share were "exactly in line with our estimates."

137. On May 15, 2000, WorldCom filed its Form 10-Q for the first quarter ended March 31, 2000 (the "1Q 2000 Form 10-Q"), which was signed by Sullivan. The 1Q 2000 Form 10-Q reiterated the consolidated financial results reported in the 1Q 2000 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

138. The statements referenced in ¶¶ 135 and 137 above relating to WorldCom's first quarter 2000 results were each false and materially misleading because, as described above, the Company's revenues, earnings, pretax income, assets and net worth for the quarter were materially overstated, and expenses were materially understated, in violation of GAAP.

False and Misleading Statements Relating to the 2000 Second Quarter

139. On July 13, 2000, WorldCom issued a press release announcing the termination of its merger agreement with Sprint, following indications that the Department of Justice would not approve the merger. In the press release, Ebbers stated:

> Moving forward, WorldCom remains the best-positioned global carrier with a clear focus on the highest-growth sectors of the domestic and global telecommunications marketplace.
>
> WorldCom has continued to expand on its core strengths since the merger was proposed last year. We have consistently produced significant quarter-to-quarter revenue growth in the data, Internet and international communications services – businesses that represent $18 billion of our annual revenue, growing 32 percent annually. Without a doubt, these high-growth areas represent the future of the industry and our company.

140. On July 27, 2000, WorldCom issued a press release announcing its financial results for the second quarter ended June 30, 2000 (the "2Q 2000 Press Release"). The 2Q 2000 Press Release reported "solid profitability gains" for the second quarter of 2000, including net income of $1.3 billion for the quarter, or $0.46 per common share. Commenting on these results, Ebbers stated:

> We will continue to expand the reach of our industry-leading global network as we sharpen our focus on higher-margin, value-added services in the commercial data, Internet and international markets. Furthermore, our continued capital investments in these high-growth areas of our business bolster our confidence in our ability to grow revenues and profitability in an extremely competitive business environment.

141. The press release further represented that WorldCom's operating income was $2.5 billion, a 41% increase over the same period of the prior year, and that these results were "driven by revenue increases in data, Internet and international services, combined with declining access and technology costs."

142. Also on July 27, 2000, WorldCom sponsored a conference call for financial analysts and investors to report on the second quarter 2000 results. During the call, Ebbers represented that "WorldCom posted a strong quarter with record revenue and record profit." Sullivan further stated that, despite "current softness in the voice wholesale markets," it was "realistic" to expect that the Company would post revenue growth "at or near the low end of our guidance" for the following two quarters.

143. On August 14, 2000, WorldCom filed its Form 10-Q for the second quarter ended June 30, 2000 (the "2Q 2000 Form 10-Q"), which was signed by Sullivan. The 2Q 2000 Form 10-Q reiterated the consolidated financial results reported in the 2Q 2000 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature)

which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

144. The statements referenced in the above paragraphs relating to WorldCom's second quarter 2000 results were each false and materially misleading because, as described above, revenues, earnings, pretax income, assets and net worth for the quarter were materially overstated, and expenses materially understated, in violation of GAAP.

False and Misleading Statements Relating to the 2000 Third Quarter

145. On October 26, 2000, WorldCom issued a press release announcing its financial results for the quarter ended September 30, 2000 (the "3Q 2000 Press Release"). The 3Q 2000 Press Release reported "unmatched" revenue growth, including net income of $1.4 billion, or $0.47 per common share, for the quarter:

> Consolidated revenues for the third quarter increased 12 percent over last year's comparable quarter, reflecting continued growth from global broadband services. Operating income increased by $360 million or 16 percent from the third quarter of 1999 to $2.6 billion. WorldCom's commercial services achieved revenue growth of 19 percent over third quarter 1999. Cash earnings (earnings before goodwill amortization) per share increased 21 percent year-over-year to $0.57 per common share. Net income applicable to common shareholders increased 26 percent to $1.4 billion, or $0.47 per common share, up from $0.37 per share in the third quarter of 1999.

146. On October 26, 2000, Grubman stated that the Company's quarterly earnings per share "came in below our expectations in revenues but were a penny ahead of our earnings expectations." Marc Cross, an analyst at J.P. Morgan Securities Inc., stated on October 27, 2000 that "[d]espite lower than expected revenues for the quarter . . . WorldCom reported third quarter EPS (excluding non-recurring charges) of $0.47, in line with our expectations." In reality, however, WorldCom was only able to meet analysts' earnings expectations because it fraudulently reduced line cost expenses, through improper reversals of merger reserves.

147. On November 14, 2000, WorldCom filed its form 10-Q for the third quarter ended September 30, 2000 (the "3Q 2000 Form 10-Q"), which was signed by Sullivan. The 3Q 2000 Form 10-Q reiterated the consolidated financial results reported in the 3Q 2000 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

148. The statements referenced in ¶¶ 145 and 147 above relating to WorldCom's third quarter 2000 results were each false and materially misleading because, as described above, revenues, earnings, pretax income, assets and net worth for the quarter were materially overstated, in violation of GAAP. Specifically, WorldCom's third quarter 2000 financials improperly reduced line costs by $828 million – accomplished by drawing down from certain reserve accounts – thereby increasing WorldCom's publicly reported pretax income by that amount for the third quarter of 2000.

False and Misleading Statements Relating to the 2000 Fourth Quarter and Year

149. On February 8, 2001, WorldCom issued a press release reporting "solid" financial results for the quarter and full year ended December 31, 2000 (the "Full Year 2000 Press Release"). The Full Year 2000 Press Release reported WorldCom's earnings as follows:

> The solid results posted by WorldCom meet the performance expectations the Company announced on November 1 when it declared its intention to separate the Company's financial structure into two distinct groups: a high-growth unit focused on data, Internet and international operations and a high cash flow unit focused on mature businesses.
>
> Fourth quarter 2000 consolidated revenues were $9.6 billion, up from $9.3 billion in the same period of 1999. Consolidated EBITDA was $2.8 billion representing an EBITDA margin of 29 percent.

> Fourth quarter 2000 cash earnings were $1.0 billion, or 35 cents per share, versus $1.6 billion, or 54 cents per share in the year-ago period. Consolidated net income, after goodwill amortization, was $710 million or 25 cents per share in the quarter versus $1.3 billion or 44 cents per share in the same period a year ago.
>
> Full year consolidated WorldCom, Inc. revenues were $39.1 billion, up from $35.9 billion in 1999. Full-year consolidated EBITDA was $13.8 billion before charges, up from 1999 EBITDA of $12.2 billion.
>
> Full-year 2000 cash earnings were $5.8 billion or $2.00 per share, versus $5.1 billion or $1.74 per share in 1999. Consolidated net income before charges, was $4.6 billion or $1.59 per share.

150. Commenting on these results, Ebbers stated:

> WorldCom has made excellent progress . . . in Internet, data and international services, we have completed our operations and sales realignment to further solidify WorldCom's leadership in e-business communications for today's businesses . . . In the more mature areas of our businesses represented by the MCI Group, our focus on cash generation is expected to yield positive future results.

151. The Full Year 2000 Press Release further represented that the Company would meet its 2001 earnings projections:

> The Company expects full-year 2001 WorldCom Group revenue growth of between 12 and 15 percent with quarterly growth increasing through the year. The Company expects WorldCom Group cash earnings of between $1.25 and $1.35 per share for the year.
>
> …WorldCom, Inc. currently expects that full-year 2001 consolidated cash earnings will be in the Company's previous $1.55 to $1.65 per share guidance range.

152. Analysts immediately emphasized that, once again, WorldCom had met the Street's expectations. Grubman noted on February 8, 2001 that "cash EPS was a penny beater for WCOM Group ($0.28 actual vs. $0.27 est.), and hence for WCOM Inc. ($0.35 actual vs. $0.34 est.)." On February 9, 2001, Marc Crossman of J.P. Morgan Securities Inc. stated that the Company's consolidated earnings "met consensus expectations."

153. The statements referenced in ¶¶ 149 and 151 above relating to WorldCom's fourth quarter 2000 were each false and materially misleading because, as described above, revenues, earnings, pretax income, assets and net worth for the quarter were materially overstated and expenses were materially understated, in violation of GAAP. Specifically, WorldCom's fourth quarter 2000 financials improperly reduced line costs by $407 million -- accomplished by drawing down from certain reserve accounts -- thereby increasing WorldCom's publicly reported pretax income by that amount for the fourth quarter of 2000.

154. On March 30, 2001, WorldCom filed its Form 10-K for the quarter and year ended December 31, 2000 (the "2000 Form 10-K"), which was signed by Defendants Alexander, Allen, Areen, Aycock, Bobbitt, Ebbers, Galesi, Kellett, Macklin, Roberts, Sidgmore, and Sullivan. The 2000 Form 10-K reiterated the financial results reported in the Full Year 2000 Press Release and represented that the financial results contained in the Form 10-K had been prepared in accordance with GAAP.

155. The 2000 Form 10-K also touted the fact that line costs as a percentage of revenues had declined in 2000 and attributed this improvement to increased traffic on WorldCom's facilities:

> Line costs as a percentage of revenues for 2000 decreased to 38.4% as compared to 40.1% reported for the prior year. The overall improvement is a result of increased data and dedicated Internet traffic over WorldCom-owned facilities, which positively affected line costs as a percentage of revenues by approximately one and one half percentage points.

156. The 2000 Form 10-K also contained a clean audit opinion by Andersen, addressed to the shareholders of WorldCom, which represented that:

> We have audited the accompanying consolidated balance sheets of WorldCom, Inc. (a Georgia corporation) and subsidiaries as of December 31, 1999 and 2000, and the related consolidated statements of operations, shareholders' investment and cash flows for each of the years in the three-year period ended December 31, 2000. These

> financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.
>
> We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
>
> In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of WorldCom, Inc. and subsidiaries as of December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

157. Andersen's statements in the above paragraph relating to the 2000 audit were false and materially misleading because Andersen had not conducted its audit in accordance with GAAS and, further, because WorldCom's financial statements were not in conformity with GAAP.

False and Misleading Statements Relating to the 2001 First Quarter

158. On April 26, 2001, WorldCom issued a press release announcing its financial results for the quarter ended March 31, 2001 (the "1Q 2001 Press Release"), which reported WorldCom's consolidated earnings as follows:

> First quarter 2001 consolidated revenues were $9.7 billion, up from $9.6 billion in the same period of 2000. Consolidated EBITDA was $2.9 billion, representing an EBITDA margin of 30 percent.
>
> First quarter 2001 cash earnings were $1.0 billion, or 35 cents per share. Consolidated net income, after goodwill amortization, was $729 million or 25 cents per share in the quarter.

159. Commenting on these results, Ebbers stated:

> This quarter was an excellent start to what will be a pivotal year for WorldCom. These results show that WorldCom is on track to deliver strong growth and solid performance throughout the year.

160. The 1Q 2001 Press Release further represented that WorldCom "continue[d] to expect full-year 2001 WorldCom group revenue growth of between 12 and 15 percent and expect[ed] WorldCom group cash earnings of between $1.25 and $1.35 per share for the year."

161. Financial analysts noted that WorldCom's quarterly results were due, in part, to expense reductions in the WorldCom Group. Grubman noted on April 26, 2001 that "[a]ll of the EBITDA margin improvement came at the gross margin line . . . [t]echnology is driving down . . . ongoing operating costs." Marc Crossman of J.P. Morgan Securities Inc. stated on April 27, 2001 that "[r]eported EBITDA for the WorldCom Group beat our estimates slightly, reflecting better than expected expense reductions. . . ."

162. On May 15, 2001, WorldCom filed its Form 10-Q for the first quarter ended March 31, 2001 (the "1Q 2001 Form 10-Q") with the SEC. The 1Q 2001 Form 10-Q reiterated the consolidated financial results reported in the 1Q 2001 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods." The 1Q 2001 Form 10-Q was signed by Sullivan and reiterated the materially false and misleading financial information initially disclosed in the February 10, 2000 press release and conference call.

163. The statements referenced in ¶¶ 158-160 and 162 relating to WorldCom's first quarter 2001 results were each false and materially misleading because revenues, earnings, pretax income, assets, and net worth for the quarter were materially overstated, and expenses were materially understated, in violation of GAAP. Specifically, WorldCom's first quarter 2001

financials improperly reduced quarterly line costs by $771 million – accomplished by accounting for the line costs as capital expenses in a blatant violation of GAAP – thereby increasing WorldCom's publicly reported pretax income by that amount for the first quarter of 2001.

<u>False and Misleading Statements Relating to the 2001 Second Quarter</u>

164. On July 26, 2001, WorldCom issued a press release announcing WorldCom's financial results for the quarter ended June 30, 2001 (the "2Q 2001 Press Release"):

> Second quarter 2001 consolidated revenues were $8.9 billion. Consolidated EBITDA was $2.7 billion, representing an EBITDA margin of 30 percent.
>
> Second quarter 2001 cash earnings were $917 million. Consolidated net income, after goodwill amortization, was $623 million.

165. In the 2Q 2001 Press Release, Ebbers commented:

> The growth in our data and Internet revenues this quarter again demonstrates the value of enterprise customers as we continue to see our customers' requirements for more bandwidth. . . .
>
> I'm also extremely pleased with the results of our heightened focus on cash flow. The $600 million sequential improvement in internally generated cash flow this quarter is a result of good business fundamentals: solid growth, more stable pricing, efficient cost control and effective balance sheet management.

166. The market picked up on the statements regarding WorldCom's performance, especially their assurances regarding cash flow. On July 26, 2001, Grubman called the quarterly results "exceedingly good" and stated "[t]he other major highlight of the quarter was a dramatic improvement in operating cash flow . . . ."

167. On August 14, 2001, WorldCom filed with the SEC its Form 10-Q for the quarter ending June 30, 2001 (the "2Q 2001 Form 10-Q"), which was signed by Sullivan. The 2Q 2001 Form 10-Q reiterated the consolidated financial results reported in the 2Q 2001 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature)

which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

168. The statements referenced in ¶¶ 164-165 and 167 above relating to WorldCom's second quarter 2001 results were each false and materially misleading because revenues, earnings, pretax income, assets, and net worth for the quarter were materially overstated, and expenses were materially understated, in violation of GAAP. Specifically, as WorldCom has admitted, the second quarter 2001 financials improperly reduced quarterly line costs by $560 million -- accomplished by accounting for the line costs as capital expenses -- thereby increasing WorldCom's publicly reported pretax income by that amount for the second quarter of 2001.

False and Misleading Statements Relating to the 2001 Third Quarter

169. On October 25, 2001, WorldCom issued a press release announcing WorldCom's financial results for the quarter ended September 30, 2001 (the "3Q 2001 Press Release"), which reported WorldCom's earnings as follows:

> Third quarter 2001 consolidated revenues were $9.0 billion. Consolidated EBITDA was $2.7 billion, representing an EBITDA margin of 30 percent.
>
> Consolidated WorldCom, Inc. third quarter cash earnings were $797 million. Consolidated net income, after goodwill amortization, was $493 million.

170. Commenting on the Company's earnings, Ebbers stated:

> WorldCom delivered excellent growth this quarter, while substantially improving the free cash flow of our businesses . . . Our data, Internet and international businesses continue to perform well in spite of the very difficult economic environment. We still expect our growth businesses to gain market share profitably during this period of global economic uncertainty.

171. On July 26, 2001, during the third quarter 2001 earnings conference call, Ebbers commented on the Company's ability to grow revenues even while improving margins and increasing cash flow:

> From a revenue perspective, we achieved 12% revenue growth for the quarter and 12.5% growth for the first half of 2001 . . . We accomplished this while improving EBITDA margins and dramatically improving cash flow with improved cash from operations, excellent working capital management, and prudent capital spending . . . [W]e continue to deliver growth that will allow us to achieve our revenue growth target . . . .

172. During Sullivan's presentation on the conference call, he specifically attributed WorldCom's improved EBITDA margins to decreases in line costs:

> [A]ll in all, this was a solid quarter from a revenue standpoint. EBITDA [at the] WorldCom Group was $2 billion or 38% of revenues which was slightly ahead of 37% in the first quarter. Improvements in both line costs and SG&A contributed to the modest improvement in EBITDA percentage.

173. Sullivan further assured investors that new methods for accounting for goodwill would not affect WorldCom's balance sheet because, among other things, the Company had tremendous expertise in valuing its acquisitions:

> I think WorldCom has been very diligent over the years. In a lot of cases we have used two to three appraisers in each one of the acquisitions, and we have done a good job of identifying specific intangible assets that we amortized today and do not develop from the cash earnings number.

174. During the third quarter 2001 investor conference call held on October 25, 2001, Sullivan cited decreases in line costs as a primary reason for WorldCom's improved EBITDA margins:

> EBITDA for the WorldCom Group was $2.1 billion, or 38 percent of revenues, slightly ahead of second quarter's percentages. [The] improvement in EBITDA was the result of continued line-cost containment and workforce efficiency.

175. On November 14, 2001, the Company filed with the SEC its Form 10-Q for the third quarter ended September 30, 2001 (the "3Q 2001 Form 10-Q"), which was signed by Sullivan. The 3Q 2001 Form 10-Q reiterated the consolidated financial results reported in the 3Q 2001 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

176. The statements referenced in the above paragraphs relating to WorldCom's third quarter 2001 results were each false and materially misleading because revenues, earnings, pretax income, assets, and net worth for the quarter were materially overstated, and expenses were materially understated, in violation of GAAP. Specifically, WorldCom's third quarter 2001 financials improperly reduced quarterly line costs by $743 million -- accomplished by accounting for the line costs as capital expenses -- thereby increasing WorldCom's publicly reported pretax income by that amount for the third quarter of 2001.

False and Misleading Statements Relating to the 2001 Fourth Quarter and Year

177. On February 7, 2002, WorldCom issued a press release announcing its financial results for quarter and full year ended December 31, 2001 (the "Full Year 2001 Press Release"), which reported WorldCom's consolidated earnings:

> Fourth quarter 2001 consolidated revenues were $8.5 billion. Fourth quarter 2001 WorldCom, Inc. cash earnings were $570 million. Consolidated net income applicable to common shareholders was $295 million.
>
> … Full-year consolidated WorldCom, Inc. revenues were $35.2 billion, a decrease of one percent from $35.6 billion in 2000. Full-year 2001 cash earnings were $3.3 billion. Consolidated net income applicable to common shareholders was $2.1 billion.

178. Commenting on the fourth quarter and full year 2001 results, Ebbers spoke positively about WorldCom’s future:

> Moving into 2002 WorldCom is a company with a strong balance sheet, positive free cash flow, a fully integrated local to global network leveraged by a sales force aligned to deliver the products and services our customers are demanding today and prepared for where demand will take customers in the future. I am more confident than ever that WorldCom is well positioned in today’s environment, as well as when economic growth returns.

179. These statements were materially false and misleading because revenues, earnings, pretax income, assets and net worth for 2001 were materially overstated, and expenses were materially understated, in violation of GAAP. Specifically, WorldCom’s 2001 financials improperly reduced line cost expenses by $3.055 billion, thereby increasing pretax income by that same amount.

180. During the fourth quarter 2001 earnings conference call, held on February 7, 2002, Ebbers announced that WorldCom “will likely write-down goodwill by between $15 to $20 billion . . . .” When analysts raised questions about the Company’s accounting practices, Ebbers assured investors that WorldCom’s accounting practices were sound and reliable: "I highly recommend everyone take a step back and focus on reality rather than the fear factor." Ebbers dismissed rumors circulating about WorldCom's viability as "unfounded nonsense," and further falsely stated that "we stand by our accounting." And, Ebbers falsely informed investors that WorldCom’s financials were healthy, stating: “We have a solid bill-paying customer base, $10.5 billion in current assets, $39 billion of property, plan and equipment, and we have solid investment grade debt ratings, and we are free cash flow positive ahead of time . . . Bankruptcy or a credit default is not a concern.”

181. In response to Ebbers' assurances, investors bid WorldCom stock up to its closing price of $7.52 on February 7, 2002, an increase of nearly 15% over the prior day's closing price. It continued to rise, closing at $9.01 on March 11, 2002.

182. On March 7, 2002, the SEC requested production of documents and information from WorldCom, including: (a) information on the Company's third quarter 2000 pretax charge associated with wholesale accounts, disputed customer bills and sales commissions; (b) the Company's accounting policies for goodwill and FAS 142; (c) documents relating to reserves discussed in WorldCom's third quarter 2001 Form 10-Q, such as bankruptcies, litigation, and contractual settlements; (d) loans to Ebbers; (e) billing practices, including customer complaints; and (f) organizational charts and personnel records for former employees.

183. On March 12, 2002, one day after news of the SEC inquiry was broadcast across the Dow Jones Newswires, WorldCom's stock plunged to $7.93 per share, down $1.08 from the prior day's closing price of $9.01.

184. In a news conference held on March 12, 2002, Ebbers once again falsely assured investors that rumors regarding the Company's accounting practices were unfounded and that he was unaware of the reason for the SEC investigation. According to Dow Jones Business News, Ebbers told investors: "We are not aware of any information that would give rise to this inquiry other than newspaper articles." Ebbers further stated that the Company's accounting policies and practices were fully compliant with the SEC's rules.

185. On March 13, 2002, WorldCom filed with the SEC its Form 10-K for the fourth quarter and year end December 31, 2001 (the "2001 Form 10-K"), which was signed by defendants Allen, Areen, Aycock, Bobbitt, Ebbers, Galesi, Kellett, Macklin, Roberts, Sidgmore, and Sullivan. The 2001 Form 10-K reiterated the false financial results reported in the Full Year 2001 Press

Release and falsely represented that the financial results contained in the Form 10-K had been prepared in accordance with GAAP.

186. The 2001 Form 10-K falsely reported that line costs as a percentage of revenues for 2001 were 41.9% -- a slight increase over the line costs for 2000. In reality, the line costs percentage was much higher but was concealed by the fraudulent accounting.

187. The 2001 Form 10-K also contained a clean audit opinion by Andersen, addressed to the shareholders of WorldCom, which represented that:

> We have audited the accompanying consolidated balance sheets of WorldCom, Inc. (a Georgia corporation) and subsidiaries as of December 31, 2000 and 2001, and the related consolidated statements of operations, shareholders' investment and cash flows for each of the years in the three-year period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.
>
> We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
>
> In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of WorldCom, Inc. and subsidiaries as of December 31, 2000 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

188. Andersen's statements in the above paragraph relating to the 2001 audit were false and materially misleading because Andersen had not conducted its audit in accordance with GAAS and, further, because WorldCom's financial statements were not in conformity with GAAP.

False and Misleading Statements Relating to the 2002 First Quarter

189. On April 25, 2002, WorldCom issued a press release announcing its financial results for the quarter ended March 31, 2002 (the "1Q 2002 Press Release"), which stated:

> WorldCom, Inc. first quarter 2002 consolidated revenues were $8.1 billion, an 8 percent decline from the year-ago period. Consolidated net income was $130 million, including a $90 million after-tax charge associated with the disposition of investments, such as News Corporation. Excluding this charge, consolidated net income would have been $220 million.
>
> First quarter 2002 consolidated free cash flow from operations was $952 million. Consolidated net debt declined by $903 million to $27.9 billion. WorldCom, Inc. 2002 capital expenditures are expected to be up to $4.9 billion.

190. Ebbers stated in the 1Q 2002 Press Release:

> Despite very difficult performance this quarter WorldCom was able to generate free cash flow from operations and reduce net debt by $903 million . . . Our data and Internet production was affected by disconnects from e-business oriented customers as well as cost driven network reductions from enterprise customers. Voice revenues are pressured by price reductions and network downsizing by existing customers that offset new billed revenue.

191. During the first quarter 2002 earnings conference call held on April 25, 2002, Ebbers rejected the notion that WorldCom would not be able to pay its debt maturities: "[W]e feel very, very confident that we will be able to meet our debt maturity requirements to pay off our debt." And, Sullivan stated that, despite WorldCom's "significant" decline in revenues during the quarter, the Company's EBITDA margins had declined only slightly:

> [In the fourth quarter of 2001,] [o]ur EBITDA at the WorldCom Group was about 38% of revenue. And let's face it, we had a pretty significant decline in the first-quarter revenue for all of the reasons that I have already laid out. And despite all of that our EBITDA percentage in the first quarter [of 2002] was still 35%.

192. On April 30, 2002, WorldCom announced that defendant Ebbers had suddenly resigned his posts as WorldCom's Chief Executive Officer, President, and Director. Within three days, WorldCom's stock dropped to $1.79.

193. On May 15, 2002, WorldCom filed with the SEC its Form 10-Q for the quarter ended March 31, 2002 (the "1Q 2002 Form 10-Q"), which was signed by defendant Sullivan. The 1Q 2002 Form 10-Q reiterated the consolidated financial results reported in the 1Q 2002 Press Release and represented that "the financial statements reflect all adjustments (of a normal and recurring nature) which are necessary to present fairly the financial position, results of operations and cash flows for the interim periods."

194. Sullivan reiterated these same statements during a conference call hosted by WorldCom on May 15, 2002 to discuss the announcement of the $2.65 billion credit facility draw down.

195. The statements referenced in the above paragraphs relating to WorldCom's first quarter 2002 results were each false and materially misleading because revenues, earnings, pretax income, assets, and net worth for the quarter were materially overstated, and expenses materially understated, in violation of GAAP. Specifically, WorldCom's first quarter 2002 financials improperly reduced quarterly line costs by $818 million – accomplished by accounting for the line costs as capital expenses -- thereby increasing WorldCom's publicly reported pretax income by that amount for the first quarter of 2002.

<u>The False and Misleading Registration Statements (Bonds)</u>

A. The May 2000 Offering

196. On or about May 24, 2000, WorldCom issued $5 billion worth of bonds as follows: $1,500,000,000 Floating Rate Notes due November 26, 2001; $1,000,000,000 worth of 7.875%

Notes due May 15, 2003; $1,250,000,000 worth of 8.000% Notes due May 15, 2006; and $1,250,000,000 worth of 8.000% Notes due May 15, 2010 (collectively, the "2000 Offering") pursuant to a Form S-3 registration statement dated April 12, 2000, an amended Form S-3 registration statement dated May 11, 2000, a Form 424(B)(5) prospectus supplement dated May 15, 2000, and a Form 244(B)(5) prospectus supplement dated May 22, 2000 (collectively, the "2000 Registration Statement"), which were filed with the SEC.

197. The 2000 Registration Statement was signed by defendants Alexander, Allen, Areen, Aycock, Bobbitt, Ebbers, Sullivan, Galesi, Kellet, Macklin, Porter, Roberts, Sidgmore and Tucker.

198. The following Underwriters Defendants were identified as underwriters of the 2000 Offering: Salomon, J.P. Morgan, Banc of America, Chase, Lehman Brothers, Blaylock, CSFB, Deutsche Bank, Goldman Sachs and UBS Warburg. Salomon and J.P. Morgan served as the lead managers of this Offering.

199. The 2000 Registration Statement included WorldCom's materially false and misleading financial statements for 1999, and also incorporated by reference the following documents:

> -WorldCom's Annual Report on Form 10-K for the year ended December 31, 1999;
>
> -WorldCom's Form 8-K, filed on May 16, 2000, which included WorldCom's Form 10-Q for the first quarter of 2000; and
>
> -Andersen's audit opinion included in WorldCom's Annual Report on Form 10-K for the year ended December 31, 1999.

200. Andersen gave its written consent to incorporation of its audit opinion for WorldCom's 1999 annual financial statements as part of the prospectus and Form S-3 relating to this Offering.

201. For the reasons set forth in ¶¶ 111 through 138 above, the financial statements for 1999 and the first quarter of 2000 which were included and incorporated in the May 2000 registration statement, were materially false and misleading because they materially overstated WorldCom's earnings and assets.

202. In addition, the registration statement issued in connection with the 2000 Offering was materially false and misleading because, as set forth in more detail in ¶¶ 196 through 200, it failed to disclose the inherent conflicts of interest between Salomon, the lead underwriter of this Offering, and WorldCom.

B. The May 2001 Note Offering

203. In May 2001, WorldCom issued approximately $11.8 billion worth of bonds as follows: $1,500,000,000 worth of 6.50% Notes due May 15, 2004; $4,000,000,000 worth of 7.50% Notes due May 15, 2011; $4,600,000,000 worth of 8.25% Notes due May 15, 2031; €1,250,000,000 worth of 6.75% Notes due May 15, 2008; and £500,000,000 worth of 7.25% Notes due May 15, 2008, pursuant to a Form S-3 Registration Statement dated May 9, 2001 and a Form 424(B)(5) Prospectus Supplement dated May 11, 2001 (collectively the "May 2001 Registration Statement"), which were filed with the SEC. The 2001 Offering was among the largest debt offerings in U.S. history.

204. The May 2001 Registration Statement was signed by defendants Alexander, Allen, Areen, Aycock, Bobbitt, Ebbers, Sullivan, Galesi, Kellet, Macklin, Porter, Roberts and Sidgmore.

205. The following Underwriter Defendants were identified in the May 2001 Registration Statement as the underwriters: Salomon, J.P. Morgan, Banc of America, ABN/AMRO, Mitsubishi, Westdeutsche, BNP, Fleet, Blaylock, Caboto, Mizuho and Utendahl. J.P. Morgan and Salomon served as the joint book runners of the 2001 Offering; ABN/AMRO acted as joint lead manager;

Mitsubishi and Westdeutsche acted as senior co-manager, and BNP, Fleet, Blaylock, Caboto, Mizuho and Utendahl served as co-managers.

206. In the May 2001 Registration Statement, WorldCom and the aforementioned Underwriter Defendants set forth financial data for 1999 and 2000 that were consistent with financial statements previously filed with the SEC by WorldCom.

207. In addition, the 2001 Registration Statement incorporated by reference the following documents:

> -WorldCom's Annual Report on Form 10-K for the year ended December 31, 2000, as amended on Form 10-K/A;
>
> -WorldCom's Current Reports on Form 8-K dated April 26, 2001, which included the press release issued by WorldCom that day announcing its results for the first quarter of 2001; and
>
> -Andersen's audit opinion included in WorldCom's Annual Report on Form 10-K for the year ended December 31, 2000.

208. Andersen gave its written consent to incorporation of its audit report on WorldCom's 2000 annual financial statements as part of the prospectus and Form S-3s on the WorldCom Notes.

209. For the reasons set forth in ¶¶ 203 through 208 above, the financial statements incorporated in the May 2001 Registration Statement were materially false and misleading.

210. In addition, the May 2001 Registration Statement was materially false and misleading because, as set forth in more detail in ¶¶ 226 through 255, it failed to disclose the inherent conflicts of interest between Salomon, the lead underwriter of this Offering, and WorldCom.

211. Although WorldCom reported across-the-board improvements in operating income, revenue, and profitability and "outstanding" financial achievements, defendants knew or recklessly

disregarded that the Company's revenues and profits for fiscal years ended December 31, 1999, 2000 and 2001, the interim quarters within those years, and the first quarter 2002 were artificially inflated by billions of dollars through a variety of fraudulent accounting practices. WorldCom was able to inflate these financial results by, among other things, improper capitalization of expenses, improper reduction of reserves, excessive acquisition write-offs, and improper revenue recognition.

The False and Misleading Registration Statements Issued in Connection with WorldCom Acquisitions

A. The SkyTel Acquisition

212. On August 26, 1999, WorldCom filed a Form S-4 registration statement with the SEC for the acquisition of SkyTel Communications, through a merger of SkyTel into a wholly owned subsidiary of WorldCom. In the transaction, each outstanding share of SkyTel common stock was converted into the right to receive 0.3849 shares of WorldCom common stock. On October 1, 1999, WorldCom filed a Form S-3 registration statement in connection with the Sky-Tel acquisition. The transaction, which was completed on October 1, 1999, issued approximately 23 million shares of WorldCom stock to Sky-Tel shareholders.

213. The Form S-4 for the SkyTel acquisition set the date for shareholder meetings to vote on the acquisition for September 29, 1999. The Form S-3 included and incorporated by reference the financial statements issued by WorldCom for the year ended December 31, 1998, and for the six months ended June 30, 1999. For the six months ended June 30, 1999, the financial statements included in that registration statement reported revenues of $17.945 billion (an increase of nearly four times the $4.901 billion for the six months ended June 30, 1998), and operating income of $3.259 million (an increase of 7 times the $0.423 million for the six months ended June 30, 1998).

214. For the reasons stated in ¶¶ 212 through 213 above, the financial statements for the first and second quarters of 1999 reported and incorporated by reference in the registration statement for the SkyTel acquisition were materially false and misleading.

215. The registration statement for the SkyTel acquisition was signed by or with authorization on behalf of defendants Alexander, Allen, Areen, Aycock, Bobbitt, Ebbers, Galesi, Kellett, Macklin, Porter, Roberts, Sidgmore, Sullivan and Tucker.

B. The Intermedia Acquisition

216. On October 16, 2000, WorldCom filed a draft Form S-4 registration statement with the SEC for the acquisition of Intermedia Communications Inc., through a merger of a wholly owned subsidiary of WorldCom with and into Intermedia, with Intermedia remaining as the surviving corporation and as a WorldCom subsidiary. A final version of the Form S-4/A registration statement was filed on May 14, 2001.

217. In the transaction, in which Intermedia was acquired for approximately $5.8 billion, including assumed long-term debt, stockholders of Intermedia received one share of WorldCom stock (or 57.1 million shares of WorldCom stock in the aggregate) and 1/25 of a share of WorldCom's MCI Tracking stock (or 2.3 million MCI group shares in the aggregate) for each share of Intermedia stock they owned. The Intermedia acquisition was completed on July 1, 2001. The transaction implemented the companies' Agreement and Plan of Merger, dated September 1, 2000, as amended by first and second amendments to the Agreement and Plan of Merger, dated February 15, 2001, and May 14, 2001.

218. The registration statement for the Intermedia acquisition set the date for shareholder meetings to vote on the acquisition for June 19, 2001. The registration statement, which contained the proxy statement/prospectus, set forth a summary of WorldCom's reported financial statements

for the years 1996 through 2000 (including its now-admitted overstated earnings in 1999 and 2000), and further incorporated by reference various documents that WorldCom had previously filed with the SEC, which were described as containing "important business and financial information about WorldCom." The documents incorporated by referenced included: WorldCom's Annual Report on Forms 8-K, as amended by Amendment No. 1, dated April 25, 2001 (filed April 26, 2001); the Proxy Statement filed April 26, 2001; and Current Reports on Form 10-K, including filings dated February 8, March 14, March 28, April 26 and May 1, 2001. Thus, the registration statement incorporated by reference WorldCom's financial statements for the years ended December 31, 1999 and 2000, and for the three months ended March 31, 2001.

219. For the reasons specified in ¶¶ 216 through 218 above, the financial statements for the years 1999 and 2000, and for the first quarter in 2001, which were incorporated by reference in the registration statement for the Intermedia acquisition were materially false and misleading.

220. The registration statement for the Intermedia acquisition was signed by or with authorization on behalf of defendants Alexander, Allen, Areen, Aycock, Bobbitt, Ebbers, Galesi, Kellett, Macklin, Roberts, Sidgmore and Sullivan. It further included, as Exhibit 23.1, a Consent of Arthur Andersen LLP to the inclusion of its opinion statement with respect to the Company's 2000 financial statements.

THE NEFARIOUS RELATIONSHIP BETWEEN SALOMON AND WORLDCOM

The Investment Banking Business According to Salomon

221. Over the past six years, Salomon became the preeminent investment banking firm in the telecommunications sector of the market. Since 1996, Salomon worked with over eighty telecommunications companies to raise approximately $190 billion in debt and equity. In return, according to Thomson Financial, Salomon collected from telecommunications companies

approximately $809 million in fees relating to underwriting services and approximately $178 million in fees relating to financial advice in connection with mergers and acquisition in the period between 1997-2001. Salomon's fees for that period were well over 40% greater than those of its closest rival in the telecommunication industry, Merrill Lynch.

222. Recent events and documents disclosed to the public, however, reveal that underlying Salomon's stunning success was a complex scheme of what the New York Attorney General has described as "commercial bribery." To obtain the coveted investment banking services and fees, Salomon enticed top executives of telecommunications companies with a package of Wall Street's hottest currencies: (1) a guarantee of favorable analyst reports and ratings to bolster the value of the potential client's stocks; and (2) for the decision-makers at the potential clients, lucrative shares in "hot" initial public offerings. This illicit, multi-faceted quid pro quo arrangement was never disclosed to WorldCom investors, who relied on the supposed integrity of Salomon's underwriting process and the independence of Salomon's research.

The Initial Public Offering Process

223. By way of background, an initial public offering, or "IPO," is the first public issuance of stock from a company that has never been publicly traded. Wall Street investment banks like Salomon are key players in the complex process of underwriting, that is, bringing to market, the IPOs. In a "firm commitment" IPO, the standard form of equity offering in the United States, the issuer enters into an underwriting agreement to sell all of the offered securities to an underwriting syndicate. The syndicate members in turn sell the offered shares to the public at a set offering price (or at a discount to dealers who then resell the shares to the public).

224. The NASD defines a "hot issue" as securities from an initial public offering which trade at a premium in the secondary market whenever such secondary market begins trading

(hereinafter, "Hot IPO Shares"). The perception that a particular issue is "hot" creates a very high demand for the Hot IPO Shares in the secondary market. This in turn raises the prices of such shares in the secondary markets, often to extraordinary amounts. Consequently, the ability to purchase Hot IPO Shares at the IPO price creates a tremendous opportunity for a quick profit. An investor purchasing Hot IPO Shares at the IPO price can sell the shares in the secondary market within days, or even hours, from the initial purchase for an immediate and hefty profit. Thus, Hot IPO Shares became known as one of Wall Street's hottest currencies, or so called "free money."

225. Although, in general, under the NASD regulations, underwriters may not withhold Hot IPO Shares for their own accounts, the lead underwriters in the syndicate are usually awarded between 70% to 85% of the total IPO shares and have substantial, if not exclusive, discretion to allocate the IPO shares to their favored customers. The ability to selectively allocate the highly coveted Hot IPO Shares provides the lead underwriters with a powerful tool to reward their top investment banking clients for past business and to "encourage" them (or new, would-be clients) to provide investment banking business in the future.

Salomon's Allocation of Hot IPO Shares

226. Documents produced by Salomon in connection with various governmental investigations reveal that Salomon's systematic and selective allocation of Hot IPO Shares in exchange for investment banking services amply support the New York Attorney General's concerns about "commercial bribery." For example, The Wall Street Journal reported that Peggy Paterson, spokeswoman for the House of Representatives Committee on Financial Services, said that documents produced by Salomon led to "an inescapable conclusion that the [IPO] shares were offered in order to leverage investment banking business." (Emphasis added).

227. Since 1996, Salomon repeatedly allocated thousands of Hot IPO Shares to the same top executives of the same telecommunications companies. In return, these executives, who were all in the position to determine or influence the selection of their company's financial advisers or underwriters, repeatedly directed to Salomon investment banking business worth many millions of dollars.

228. Specifically, according to a complaint filed by Elliot Spitzer, the New York State Attorney General, on September 30, 2002 (the "Attorney General's Complaint") and documents produced by Citigroup on Salomon's behalf to the House Committee on Financial Services, these executives included, but were not limited to, Philip F. Anschutz, former Chairman of Qwest Communications, who was allocated Hot IPO Shares on at least fifty-seven occasions and who derived $4.8 million in profit; Joseph Nacchio, former Chief Executive of Qwest Communications, who was allocated Hot IPO Shares on at least forty-two occasions and who derived $1 million in profit; Stephen Garofalo, founder of Metromedia Fiber Network, Inc., who was allocated Hot IPO Shares on at least thirty-seven occasions and who derived $1.5 million in profit; Clark McLeod, founder of McLeod Telecommunications, who was allocated Hot IPO Shares on at least thirty-two occasions and who derived $9.4 million in profit; and, last but not least, Ebbers of WorldCom, who was allocated Hot IPO Shares by Salomon on at least twenty-one occasions and derived a whopping $11.5 million in profit. In addition, Sullivan, WorldCom's chief financial officer, received at least 32,300 Hot IPO Shares in nine companies, and defendant Kellett, a WorldCom director, received at least 31,550 Hot IPO Shares from Salomon. In the same period, Salomon underwrote or advised on eighteen deals for Qwest, fifteen deals for Metromedia, sixteen deals for McLeod, and twenty-three deals for WorldCom. <u>These deals generated $240 million in fees for Salomon</u>.

229. Indeed, some of the issues allocated to Ebbers were not just hot, but scorching. For example, according to a chart Citigroup provided to the House Committee on Financial Services in August 2002, Ebbers received approximately 10,000 shares of the IPO of Rhythms NetConnections Inc. ("Rhythms"), whose stock soared 229% on its first trading day in April 1999.

230. In addition, the NYSCRF's investigation has determined that Salomon may have actually materially understated the amount of shares that Ebbers received. In response to a request for the number of IPO shares allocated to each WorldCom "officer," Salomon provided documents to Congress that showed that, among other allocations, Ebbers received 10,000 shares of the IPO of Rhythms. However, a former Salomon broker stated that he was informed by Rick Olson, Ebbers' broker at Salomon, that he "got Bernie 350,000 shares" of that IPO. Pending discovery, it is unclear if Olson was referring to shares that might have been allocated to members of Ebbers' family or to one of his many trusts or businesses.

231. Even assuming Citigroup's submission to Congress was full and complete, Ebbers' allocations also often represented very high percentages of Salomon's total allotment. For example, Ebbers was awarded two-thirds of Salomon's entire retail allocation involving the IPO of McLeod in June 1996 -- 200,000 shares valued at $20 million. Ebbers also received 200,000 shares of Nextlink Communication, or 10.52 % of Salomon's entire retail allotment, and 205,000 shares in Qwest, or 12.42% of the entire Salomon allocation. As Salomon admitted in its August 7, 2002 letter to the Committee on Financial Services, "some allocations to corporate officers and directors . . . were sufficiently large as to raise questions about the appearance of conflicts."

Salomon's "Independent" Research Department

232. In addition to selective and manipulative allocation of Hot IPO Shares, Salomon also used another covert currency -- the allegedly "independent" analyst research reports and

ratings -- to gain additional investment banking business. Although investment banks, including Salomon, have long assured investors that their investment banking and research departments are separated by what is called a "Chinese Wall" to prevent conflicts of interest, the documents referred to in the Attorney General's Complaint and elsewhere demonstrate that Salomon had a very different idea of how to manage the "separation" between these two departments.

233. For instance, in January 1998, John Hoffmann, the head of Salomon's Global Equity Research Management, noted "a continuing shift in the realization that <u>an analyst is the key element in banking success</u>." (Emphasis added). On December 8, 2000, Hoffman wrote to Michael Carpenter that one of his goals as global director of research was "to better integrate our research product with the business development plans of our constituencies, <u>particularly investment banking</u> . . . ." (Emphasis added)

234. In fact, it was well known at Salomon that the purportedly independent research process was a farce. In December 2000, Hoffman told Carpenter that there was "legitimate concern" about the objectivity of Salomon's analysts and further observed that there was a "rising issue of research integrity" and a "basic inherent conflict" between investment banking and research. In February 2001, Jay Mandelbaum, the global head of Salomon's retail stock selling division, told Hoffman that Salomon's "research was basically worthless." At that time, Salomon provided research coverage of 1,179 public companies and employed a five-tier stock rating system: (a) Buy; (b) Outperform; (c) Neutral; (d) Underperform; and (e) Sell. The "Buy" rating was the highest possible for a particular stock, with each successive tier indicating an increasingly lower recommendation.

235. Consistent with Salomon's goal of <u>de facto</u> integration of the research department and the investment banking department, and as revealed in the Attorney General's Complaint and

elsewhere, Salomon began to involve research analysts in the underwriting process, and, further, in the very process of developing the lists of potential investment banking clients and in the "beauty contest" for prospective investment banking services. Since the top Wall Street investment banks have traditionally charged similar underwriting fees, the prospect of favorable research coverage by a well-recognized and widely-followed analyst became a key factor in a company's selection of an underwriter. Since the mid-1990's, it eventually became clear that, at least with respect to the telecommunications industry sector, Salomon could deliver the research coverage of a telecom executive's dream: glowing analyst reports written by Jack Grubman.

<u>The Grubman Factor</u>

236. Grubman was, until August 15, 2002, Salomon's top telecommunications analyst, and one of the most powerful men on Wall Street. As observed by <u>Time Magazine</u> on August 5, 2002, "every big investor knew Grubman was the 'ax,' the one man who could make or break any stock in [the telecommunications] industry with a thumbs-up or thumbs-down."

237. Grubman's success within the ranks of Salomon's analysts was unquestionably linked to his particular receptiveness to the desires of Salomon's investment bankers and their top clients. Although his research was presented to the public as independent, the facts and documents revealed in connection with various governmental investigations into Salomon's practices demonstrate that Grubman was in no way "independent" of the companies he covered.

238. For example, it was recently disclosed that Grubman was more of a strategic adviser or merger broker to the companies he covered, rather than an objective analyst. In its August 7, 2002 letter to the House Committee on Financial Services, Citigroup disclosed that since 1997, Grubman had attended at least ten meetings of the board of directors of Salomon's top investment banking clients, including at least two meetings of WorldCom's Board of Directors. Most of these

meetings (frequently held at the invitation of Salomon's investment bankers or top executive officers) related to these companies' key mergers and acquisitions, including WorldCom's acquisition of MCI and its proposed acquisition of Sprint, in which Salomon played the role of financial adviser.

239. Grubman also played a role in the allocation of Hot IPO Shares at Salomon. According to one former senior Salomon broker, Grubman was the key decision maker in Salomon's allocation of the Hot IPO Shares. As reported by The New York Times on August 4, 2002, a number of former Salomon employees stated that "the allocations have been made to executives when Salomon wanted to build relationships with the executives' companies or keep existing relationships strong." These executives were, in effect, "part of an exclusive, very prosperous club, and membership was controlled by Mr. Grubman," the Times wrote. Documents provided by Citigroup to the House Committee on Financial Services further corroborated these allegations. Citigroup produced two e-mails, dated March 31, 1999 and May 21, 1999, listing the names of executives who should be allocated Hot IPO Shares. Grubman was copied on both of these e-mails. During Grubman's testimony before Congress, however, when faced with the question whether certain executives had special access to Hot IPO shares, Grubman feigned ignorance: "I don't recall. I don't say 'yes,' I don't say 'no.'"

240. Most significantly, Grubman repeatedly issued "Buy" recommendations on stocks despite what he learned through his unique access to corporate managers. The reason? Investment banking concerns. For example, as revealed by documents produced by Salomon to the New York State Attorney General, Grubman admitted in an internal e-mail that he failed to timely downgrade certain stocks solely because of the pressure from his investment banking colleagues. In an e-mail to Kevin McCaffrey, Salomon's head of U.S. research management, Grubman observed:

> [M]ost of our banking clients are going to zero and you know I wanted to downgrade them months ago but got huge pushback from banking. I wonder of what use bankers are if all they can depend on to get business is analysts who recommend their banking clients. (Emphasis added).

241. As a further example, on February 21, 2001, Grubman issued a research note on Focal Communications, one of Solomon's major investment banking clients, reiterating his "Buy" rating on the company. After Grubman learned that Focal was dissatisfied with certain parts of his note, he e-mailed two of Salomon's investment bankers that evening with the following message:

> If I so much as hear one more f---ing peep out of them [Focal] we will put the proper rating (ie 4 not even 3) on this stock which every single smart buysider feels is going to zero. We lost credibility on MCLD and XO because we support pigs like Focal.

Earlier that day, Sherley McMahon, the senior research analyst under Grubman, received the following inquiry from an investor: "Focal and McLeod are pigs aren't they?" McMahon replied: "FCOM [Focal] definitely MCLD hold not sell."

242. Grubman's scorecard with respect to recommending "pigs like Focal" to the investing public because of investment banking pressure is startling. For example, as late as three weeks before Winstar Communications filed for bankruptcy protection, Grubman held a "Buy" recommendation on the stock. Similarly, Grubman held a "Buy" recommendation" on XO Communications until November 2, 2001, less than a month before the company filed for bankruptcy, when he downgraded it to "Neutral." In fact, Grubman had a "Buy" on Winstar from June 2000, when it traded at $40, to April 2001, when it traded at $1. Both Winstar and XO Communications were major investment banking clients of Salomon.

243. Grubman's conflicted role as both investment banker and analyst had not gone unnoticed by Salomon's own brokers. As referenced in the Attorney General's Complaint,

numerous former Salomon retail brokers who worked with Grubman believed that Grubman's stock ratings -- and in particular his ratings on WorldCom -- were false and misleading:

> "Grubman is an investment bank whore! When is the firm going to stop pimping him?"
>
> * * *
>
> "He put me as an advisor to clients in a very difficult position. My clients now question me if a stock we are recommending is an investment banking client. They asked me if we are recommending the stock because we want their banking business. Our blind support of banking (a la WCOM/T) is hurting our retail clients. With recent SEC company communication restrictions, analysis is more important than ever. We can not afford an overpriced cheerleader like Grubman."
>
> * * *
>
> "Has cost millions of dollars for SSB clients, I am appalled that he is now in a position to profit from our clients' losses, through his WCOM [investment] banking function. This sends a strong message that retail clients and retail brokers don't matter."
>
> * * *
>
> "[T]o represent himself as an analyst is an egregious act by the management of this firm. Clearly many of his Buy and table-pounding Buys were directly related to investment banking $ for him and his firm . . . Shame on him, shame on the banking division, shame on the senior management of this firm."
>
> * * *
>
> "Jack Grubman is not an analyst -- he is an investment banker."

244. In its August 7, 2002 letter to the House Committee on Financial Services, Citigroup admitted that, unbeknownst to most of the investing public, Grubman's compensation was linked to the investment banking revenues he generated. Indeed, beginning in 1997, Salomon (then Smith Barney) paid "helper's fees" to analysts as a percentage of the investment banking fees generated by the transactions on which the analysts worked. In more recent years, Salomon simply told its analysts to "list in detail your involvement in Investment Banking Transactions over the past year"

(or similar language) on their performance evaluation forms. Each analyst's compensation was then determined based on this response. In 2001, Grubman listed ninety-seven investment banking transactions in which he was involved and total investment banking revenues of $166 million. According to published reports, between 1998 and 2002, Grubman made approximately $20 million a year.

245. Both Carpenter and Weill approved Grubman's research and understood its true purpose. At least two sources have advised that Grubman reported directly to Weill. And both Grubman and Weill had close personal relationships with many of the top executives officers of the above-mentioned companies, including WorldCom's Ebbers.

246. The New York Times reported on August 30, 2002 that Grubman was so close to Ebbers that he attended Ebbers' 1999 wedding in Mississippi. Grubman and Salomon apparently considered this trip of benefit to Salomon's investment banking business, because Grubman submitted an expense report for the trip, which was approved by Salomon's investment banking department, not the research department. According to Robert Heim, a former assistant regional director for the SEC, this fact "shows [Grubman] completely crossed the line between an objective analyst and personal friend when it came to WorldCom." Moreover, the fact that Grubman's expenses were paid by the investment banking department indicates that, in reality, Salomon considered Grubman a de facto employee of that division and not its research department.

247. Few companies depended on Grubman's "research" more than WorldCom. As noted above, WorldCom's staggering growth was fueled by its acquisition frenzy. By 1998, WorldCom had acquired more than sixty companies. New acquisitions allowed WorldCom to increase its revenues and earnings and manipulate financial results by, among other things, decreasing its reserves or writing off goodwill as needed. Thus, to sustain its growth and stunning

reported financial performance, WorldCom needed to continue the acquisition process, and it needed to swallow larger and larger companies. To maintain this process, WorldCom desperately needed to maintain a consistently higher share price. Grubman's favorable research was clearly seen by WorldCom and Salomon executives as a way to help WorldCom achieve this goal.

248. For Salomon, WorldCom was the type of the company whose business it could not afford to lose. WorldCom was on its way to becoming the second largest telecommunications company in the world, with a market capitalization at its peak of more than $180 billion, and an unsurpassed appetite for lucrative acquisitions. As a client, it was an investment banker's dream.

249. Thus, throughout the Class Period , Grubman issued glowing reports extolling WorldCom's virtues, even though -- as discussed in ¶¶ 275-278 below -- Grubman came to realize that WorldCom's business model was in peril. Further, as set forth above, Salomon gave more than twenty hot IPO allocations to Ebbers, who sold them for a personal profit of more than $11.5 million. In return, Ebbers steered WorldCom's investment banking business to Salomon, which allowed Grubman to make tens of millions of dollars each year.

250. These apparent synergies and close personal contacts between Grubman and Ebbers were key reasons that WorldCom selected Salomon as its lead investment bank in all of its major acquisitions and debt offerings between 1997 and 2001. As reported by The Financial Times, WorldCom paid Salomon over $107 million for investment banking advice during that time. According to the Attorney General's Complaint, WorldCom retained Salomon to advise it on approximately twenty-three deals in that period. Some of these deals were among the largest and most coveted deals on Wall Street. For example, WorldCom retained Salomon as the lead underwriter in connection with each of its multibillion dollar notes offerings in May 2000 and May 2001. Salomon also served as WorldCom's financial advisor on its largest acquisitions, including

the $40 billion merger with MCI Communications (announced October 1, 1997); the proposed merger with Sprint (announced October 5, 1999); and the sale of a WorldCom unit to Allegiance Telecom (announced January 3, 2002). Salomon's fee in connection with the MCI merger alone was approximately $33 million. WorldCom also retained Salomon to manage its corporate stock option plans for WorldCom employees and designated Salomon as the broker for WorldCom employees' stock transactions.

251. In exchange for millions of dollars in investment banking fees from WorldCom, Salomon, consistent with its practice with respect to other telecommunications companies, delivered (as expected) Grubman's favorable research coverage, and unusually large and profitable allocations of Hot IPO Shares.

252. Salomon's complex scheme to enrich itself, and its parent Citigroup, at the expense of the investing public is currently being investigated by the United States Congress, the New York State Attorney General's Office, the Securities and Exchange Commission, and the New York Stock Exchange. On September 24, 2002, Salomon agreed to settle another investigation, by the National Association of Securities Dealers, by paying $5 million to resolve charges that Salomon and Grubman had issued false and misleading analyst reports concerning a different telecommunications company. (Grubman is contesting those charges).

253. On August 15, 2002, Grubman, the "star" telecommunications analyst at the center of Salomon's fraudulent scheme, resigned. Even though Grubman resigned amid public outrage and numerous governmental investigations relating to his research, Salomon awarded him a $32 million severance package and forgave a $19 million loan.

254. On or about September 3, 2002 , Jay Mandelbaum, head of Salomon's retail branch system, resigned. On September 8, 2002, Salomon ousted Michael Carpenter ("Carpenter"), its

Chief Executive Officer. Shortly thereafter, Salomon's parent, Citigroup, released a statement by its chairman and chief executive, Sanford I. Weill, in which Weill apologized for certain of his company's actions. In a subsequent interview, Weill further stated that "certain of our activities do not reflect the way we believe business should be done. That should never be the case, and I am sorry for that."

255. On October 9, 2002, Salomon announced the retirement of its global stock research chief, John Hoffmann, and the reassignment of the U.S. stock research chief, Kevin McCaffrey.

GRUBMAN'S MATERIALLY FALSE AND MISLEADING ANALYST REPORTS

256. During the Class Period, Grubman consistently rendered exceptionally positive research reports that helped to artificially inflate the price of WorldCom's stock.

257. All told, Grubman issued numerous reports on Worldcom during the Class Period. Set forth below are examples of false and misleading statements in those reports.

258. In a report issued on August 20, 1999, Grubman reiterated his bullish position on WorldCom:

> WorldCom has Global Scale, double digit top-line and bottom-line growth, and is trading at a market multiple on 200 EPS. Load up the truck! (Emphasis added).
>
> WCOM is likely to double earnings every two to three years for the next decade. We think that any investor who does not take advantage of current prices to buy every share of WCOM they can should seriously think about another vocation.

259. In a report issued on February 7, 2000, Grubman urged investors to take advantage of the opportunity to buy WorldCom stock at an "absurdly cheap" price:

> We are aggressively reiterating our Buy Rating on WorldCom because we think this stock is at a level that is absurdly cheap. As we see it, the market completely fails to recognize the triangulation of size, growth and valuation embedded in it and, most importantly, completely ignores the fact that WCOM has more "sexy IP/Data

> assets" than any other company in the world. In fact, on this last point we believe that a major reason for WorldCom's lagging performance has been the view that somehow the world is passing WorldCom by and the new breed of bandwidth companies (as well as other companies such as webhosting) are grabbing the growth opportunities away from WorldCom. Whereas in the past, we believe WorldCom was always viewed as the company with the initiative in driving growth opportunities.
>
> * * *
>
> WorldCom is as "cool a cat" as any company out there. There is no one on the planet that has the reach of IP network like WorldCom. We would argue that WCOM is competitive with any company in the world in the high-end value-added areas of IP. . . .

260. On April 27, 2000, Grubman attributed a recent decline of WorldCom's stock price to unwarranted concern over the Sprint merger and urged investors to load up on WorldCom stock at bargain prices:

> [T]he stock sells as if it is a smoke stack company. We are sure that investors are tired of hearing this from us, but we don't tend to run and hide when the market is not acting the way we would like it to act. <u>We will repeat often and loudly that this company is the singular most mis-priced company in the entire global telecom space</u>. We would argue that investors should take advantage of nervousness over the FON deal that is going to get done, or the fact that the market does not have proper perspective on just how stellar WCOM's financial performance is to buy this stock at ridiculously cheap prices. (Emphasis added).

261. On June 27, 2000, Grubman placed a "Strongly Reiterate Buy" recommendation on WorldCom stock, even as it became increasingly more likely that the Department of Justice would block the merger with Sprint:

> Likely collapse of the FON [Sprint] deal is unfortunate but, we believe, doesn't disrupt co's ability to grow at a double-digit rate for top & bottom line growth.
>
> * * *

> We believe investors should focus on WCOM's fundamentals and assets and not potential deals & realize that WCOM is trading significantly below 1x projected earnings growth rate.
>
> * * *
>
> Turning to WCOM, we cannot strongly emphasize enough how compelling we believe WCOM is at these levels. The overhang of the FON deal has cost WCOM's stock almost a year of what should have been much better performance. The reality is that WCOM remains the company that every major global telecom company wants to look like in terms of assets.
>
> * * *
>
> WCOM is categorically the cheapest stock by far in the world of global telecom, by our analysis. We believe it has a set of assets unmatched, and now that this deal is behind us, we believe the stock will show strength. We believe those who continue to worry about wireless overhang will be sorely disappointed that they downgraded the stock.

262. On October 26, 2000, Grubman again awarded WorldCom stock a "Buy" rating, stating that the shares were "dirt cheap" considering the Company's growth potential:

> We believe WCOM is aggressively focusing the company to achieve growth profitability . . . We are at a point where we believe WCOM's strategic focus has never been clearer. Namely, WCOM will optimize its asset base by becoming the preeminent provider of telecom services to corporate enterprises on a global basis.

263. By January 2001, the price of WorldCom stock had dropped to under $20, a decline of more than 50% from the price it was trading at on June 30, 2000, when it closed at $46. News reports suggested that WorldCom would need to lay-off a huge percentage of its workforce. Nevertheless, in a report issued on January 26, 2001, Grubman maintained his "Buy" rating on WorldCom, arguing that the news of massive lay-offs showed a "top mgmt team" focused on "achieving results." This was another trademark of Grubman's reports about WorldCom -- whenever bad news appeared to negatively impact the stock, Grubman would issue a report which

shrugged off any concerns investors might have, and assured them that WorldCom was a strong buy. To wit:

> News repts. suggest WCOM might, for restructuring, reduce workforce by as much as 10-15%. We have no specific knowledge about WCOM's plans. We would argue that if true, any downsizing indicates a top mgmt team which is very engaged, w/ a heightened focus on achieving results.
>
> * * *
>
> WCOM remains our top pick. We think it is still unrivaled . . . .

264. In a report issued on April 26, 2001, a few weeks before Salomon led WorldCom's $11.8 billion 2001 Offering, Grubman again touted the stock as "the one to own:"

> WCOM posted strong and high quality results . . . . No hiding behind the economy . . . . WCOM Group made double-digit guide. & reaffirmed full yr. Guid., in stark contrast to T, FON which had negative comm. Svc growth & lower guid. <u>Obviously, WCOM is the one to own</u>. (Emphasis added).

265. Even as WorldCom's stock price slipped, Grubman encouraged investors to buy shares in the Company on July 26, 2001, as follows:

> In our view WCOM is cheapest large cap telecom stock w/ best growth and assets w/ numbers set and visibility of fcf+ [free cash flow]. <u>Reiterate Buy</u>. (Emphasis added).
>
> * * *
>
> As we said in our note on Monday, July 23, we view WCOM as the cheapest large cap telecom stock, growing faster than anyone, with better strategic global assets. Its numbers are clearly set and it has huge visibility for fcf. <u>Obviously, we would be aggressive buyers of the stock</u>. (Emphasis added).

266. Reporting on WorldCom's third quarter 2001 earnings announcement, Grubman stated on October 25, 2001 that "WCOM has the most leverage among any telecom company" and maintained Salomon's "Buy" recommendation.

267. On September 19, 2001, mere days after the terror attacks of September 11, Grubman took the position that WorldCom was uniquely positioned to capitalize on the tragedy:

> We are strongly reiterating our Buy on WCOM because we feel investors are not fully appreciating how full a participant WCOM is in the relative stability and strength of the overall telecom industry in the aftermath of last week's tragic events.

268. On January 29, 2002 -- even as WorldCom's stock achieved record lows -- Grubman advised investors that the Company was a "best play" for recovery and urged them to buy the stock:

> WCOM traded down today on a laundry list of concerns, most of which don't make sense to us . . . We continue to believe that WCOM and AT&T remain the best plays in our group on a recovering economy. . . .

269. Indeed, even on March 12, 2002, after the SEC announced its inquiry into WorldCom's accounting and WorldCom shares plummeted to $7.93 per share, Grubman retained his Buy recommendation on the Company and dismissed the investigation as "boilerplate":

> As far as the SEC inquiry, we view this as a very straightforward -- almost boilerplate -- letter of inquiry to WCOM regarding a laundry list of items -- all of which are largely general in nature. In fact, the SEC is reviewing the 10-K's of every Fortune 500 company, something which has never been done before.

270. Grubman maintained a "Buy" recommendation on WorldCom until April 21, 2002, when the Company's shares were trading at $4 per share. Even then, Grubman only reduced the rating to "Neutral," not "Sell." Notably, at that point, it was obvious that due to the drastic decline of WorldCom's share price, WorldCom would not be seeking to acquire other companies in stock-for-stock transactions or gaining funds through the kind of note offerings for which Salomon served as a lead underwriter.

271. Grubman also used his research reports with respect to WorldCom as a marketing tools for WorldCom's key acquisitions on which Salomon served as the financial advisor. For

example, The Washington Post observed on July 6, 2000 that "Grubman was the most consistent and strident voice forecasting approval of the WorldCom-Sprint deal."

272. Indeed, according to Scott Cleland, an analyst at Legg Mason Precursor Group, after Cleland issued a report stating that the Department of Justice would block the Sprint merger, Grubman personally called several of Legg Mason's institutional investors to criticize Cleland's analysis and reinforce his view that the merger would be approved.

273. Purchasers of WorldCom securities were never informed that Ebbers and other WorldCom officers received millions of dollars in profit through hot IPO allocations from Salomon, the firm that was performing investment banking services for WorldCom, or that the compensation of Salomon's star analyst, who was consistently touting the stock, was dependent on this investment banking business. Purchasers of WorldCom securities were also never informed that this was a quid pro quo relationship, and that each of the "Buy" recommendations issued by Grubman on which investors relied was an integral part of an investment banking package of services marketed to WorldCom. They also were not told that Grubman was providing favorable ratings for WorldCom as part of a concerted effort at Salomon to obtain and retain investment banking business.

274. The failure to disclose these highly material facts rendered Grubman's analyst reports false and misleading, and further made the registration statements for which Salomon served as lead underwriter false and misleading. Specifically, Grubman authored the reports although he was well aware that WorldCom was not the value he portrayed it to be. Yet, Grubman continued to push the stock to ensure that WorldCom remained Salomon's investment banking client -- an arrangement which garnered hundreds of millions of dollars of business for Salomon --

and to ensure that he continued to receive the lucrative "helper fees" he received as a percentage of the fees from investment banking transactions on which he worked.

Grubman Alters His Analysis Methodology to Obscure WorldCom's Growing Cash Flow Problems

275. One of the principal bases that Grubman cited as justification for maintaining a "Buy" rating on WorldCom and other telecom stocks through much of the Class Period was the purportedly high amount of what he termed "discounted free cash flow" -- the discretionary money left over after a company's necessary expenses are met. Unfortunately for Grubman and WorldCom, the utility of this analytical model as a basis to tout WorldCom, by late 1999, had become seriously imperiled due to increasing capital expenditures that were cutting deeper and deeper into WorldCom's revenues. Instead of alerting investors to this development -- and what it meant in the context of his chosen model for telecom companies -- Grubman abandoned use of discounted free cash flow as the metric for WorldCom in early 2000, switching instead to emphasizing a "cash earnings" approach for the Company. When Grubman switched analytical models in early 2000, he did so only for WorldCom; he did not do so for any other of the telecom stocks he covered for another two years.

276. Grubman's switch from the discounted free cash flow model to the cash earnings model occurred just prior to the 2000 Offering in which Salomon served as lead underwriter.

277. According to a former Salomon broker, on the same day that the Salomon retail force learned of the change to Grubman's measuring technique for WorldCom, the broker spoke about the change with WorldCom CFO Sullivan. Sullivan was aware of the change in Grubman's approach, and said that he agreed that the cash earnings method was the "best way" to evaluate WorldCom's value.

278. Sullivan knew what he was talking about: one of the "benefits" of employing a cash earnings approach rather than a discounted free cash flow analysis is that the former omits the influence of any capital expenditures.

Other Elements of the Secret Relationship Between Salomon and Ebbers

A. The Secret Travelers Loans

279. The nefarious relationship between Salomon and Ebbers was not limited to Grubman's cheerleading for WorldCom and Salomon's allocation of lucrative IPO shares to Ebbers and other WorldCom insiders. In or about August 1999, Grubman and others at Salomon negotiated a $499 million loan for Ebbers from The Travelers Insurance Company ("Travelers"), a Citigroup subsidiary and the prior parent of Salomon.

280. According to a former senior Salomon broker, this fact was confirmed in part by W. Mark Lewis ("Lewis") who handled Ebbers' personal business affairs. The broker stated that WorldCom CFO Sullivan referred to Lewis as "Bernie's personal CFO." The broker, who was handling brokerage accounts for Sullivan and other senior WorldCom executives at the time, asked Sullivan how he (the broker) could best approach Ebbers about opening a brokerage account with Salomon. Sullivan referred the broker to Lewis. When the broker called Lewis, he was told that Ebbers had already had a Salomon account for a year. When asked which Salomon broker was handling Ebber's account, Lewis replied "one of Jack's [Grubman's] boys on the West Coast." According to Lewis, Grubman had put Ebbers in touch with Rick Olson, a Salomon broker in the Los Angeles area with whom Grubman was especially close. Lewis said that he did not see any opportunity for the broker to obtain any business from Ebbers in the foreseeable future because they had "a lot going on right now" that the broker had no idea about. Lewis stated that they were in the midst of negotiating for a "major loan" to be made to Ebbers by Citigroup. According to

Lewis, the loan was to be made by Travelers out of its Chicago office. Upon learning that Ebbers already had a Salomon account with Olson, the broker ceased trying to contact Ebbers on this matter. The broker later learned from a source within Salomon that Ebbers had at least one significant loan collateralized by his WorldCom stock other than the Bank of America loan described in ¶¶ 297 below.

281. The NYSCRF's investigation has discovered that, in fact, loans in the amount of $499 million were made in September 1999 to an Ebbers-controlled entity named Joshua Timberlands LLC ("Timberlands"). Ebbers used the loans in part to purchase over 460,000 acres of property in Alabama, Mississippi and Tennessee for $397 million for his own personal use. The loan amount was comprised of a $430 million "Mortgage Loan" and a $69 million "Second Mortgage Loan." Soon after the purchase, Travelers and Timberland began releasing the "mortgaged" collateral on a frequent and repeated basis -- meaning that the purported collateral was being diminished although the loan was not being paid down. There were also repeated amendments to the loan agreements. Documents described in a recent article in an Alabama newspaper indicate that the loans were secured by Ebbers' holdings in WorldCom stock. These loans by Salomon's corporate sibling were never disclosed to WorldCom shareholders, however, and as the price of WorldCom stock dropped during 2001, the pressure on Ebbers and Salomon to prop up WorldCom's share price grew. If Ebbers defaulted on the loan, foreclosure on Travelers' "mortgage" collateral -- now depleted and never sufficient to cover the excess loan -- could not satisfy the outstanding debt.

282. The structure of this transaction masked the inherent conflict of interest relating to the grant of this loan vis-à-vis Salomon's provision of investment banking services and "independent" research coverage to WorldCom. The huge loans were made by Travelers, a non-

banking entity, and not by Citibank or Salomon, to a holding company controlled by Ebbers, rather than Ebbers himself. This disguised the fact that the parent of Salomon, the lead underwriter of WorldCom's securities and provider of allegedly independent research reports on WorldCom, was on the hook to lose up to a half-billion dollars if the price of WorldCom's securities dropped below a certain level.

283. These facts, and the existence of these massive loans, have never been publicly disclosed. However, they are confirmed by the following facts. According to Kimberly-Clark Corporation's ("Kimberly-Clark") 1999 Form 10-K, on September 30, 1999, Kimberly-Clark sold approximately 460,000 acres of timberlands to a "non-affiliated buyer, Joshua Timberlands LLC for notes receivable having a face value of $397 million." That Form 10-K did not disclose who the true buyer party in interest was, or the bank that had backed the note, stating only that the note was "backed by irrevocable standby letters of credit issued by a major money-center bank."

284. On April 18, 2002, as part of the consolidation of prior loans owed to WorldCom by Ebbers, Ebbers entered into a Pledge and Security Agreement (the "Pledge Agreement") with WorldCom, pursuant to which Ebbers agreed to grant WorldCom an interest in certain collateral in exchange for a $400 million loan from the Company. The Pledge Agreement revealed that Ebbers owned 86% of a company called Joshua Holdings, LLC ("Holdings"). According to corporate records filed with the State of Mississippi, the registered agent for both Timberlands and Holdings is Lewis, Ebbers' "personal CFO." Timberlands and Holdings both were established in August 1999 (one month before Ebbers acquired the Kimberly-Clark property), and both entities have the identical business address: 121 S. Railroad Avenue, Suite 200, Brookhaven, MS 39601. The Pledge and Security Agreement also revealed that the entity which made the loan to Timberlands in September 1999 was Travelers. In addition, a financing statement filed by Morgan Guaranty Trust

Co. of New York ("Morgan Guaranty") in Mississippi on July 25, 2001 reveals the amount of the initial loans from Travelers to Timberlands, namely $430 million and $69 million.

285. Indeed, the Pledge Agreement states that, on February 15, 2000, Travelers had entered into an amended and restated loan agreement with Timberlands. Public record obtained in the NYSCRF's investigation show that the original Loan Agreement between Timberlands and Travelers was executed in September 1999, when Timberlands purchased the property from Kimberly-Clark. Furthermore, in contrast to the Morgan Guaranty statement, the Pledge and Security Agreement states that the only limitation on Ebbers' rights to the assets of Holdings is certain restrictions set forth in the "Travelers Loan Agreement," which limits Ebbers' rights to transfer the property, but does not describe Travelers' security interest as a mortgage in the property. This is further support that Travelers' "mortgage" was a mere shell and the loan was secured by Ebbers' personal WorldCom shares.

286. In addition to the $499 million that Travelers loaned Ebbers for the purchase of the $397 million property in 1999, Timberlands and Travelers entered into an additional $180 million loan in or about February 2000. This loan was to be secured by the same financing statement filed for the original $499 million loan, as were "any other loans involving Debtor [Ebbers] and Secured Party [Travelers]". This meant that loans tied to the $397 million property now totaled $<u>679 million</u>.

287. A document filed in the State of Mississippi indicates that Mark Lewis, Ebbers' "personal CFO," also received a loan of note -- from <u>WorldCom</u> on or about April 18, 2002, the same day the Company consolidated Ebbers' $408 million loan. The documents does not disclose the amount of the loan to Lewis.

B. Grubman's Finder's Fees and Commissions

288. In addition, the NYSCRF's investigation to date has uncovered a potential, additional threads in the nefarious relationship between Citigroup, Grubman and Ebbers.

289. According to a former Group President of Salomon, Citigroup employees who bring business to the company in a line of business outside their assigned area are typically entitled to a "finder's fee" for doing so. According to this former Salomon officer, as a research analyst, Grubman was likely entitled to some or all of a finder's fee on the various loans that Travelers made to Ebbers. According to the former officer, the finder's fee for loans was typically 15% of the company's profit on the first loan, 10% on the second, and 5% on the third.

290. The same former Group President, who was responsible for Salomon's retail sales force on the East Coast, also stated that it was "inconceivable" that Grubman did not receive a commission on the Hot IPO Shares allocated to his clients.

C. Sullivan Demands Greater Shares of IPO Allocations and Salomon and Ebbers Willingly Comply

291. As stated above, Sullivan also received allocations of Hot IPO Shares from Salomon. In some instances, Sullivan expressed dissatisfaction with his allotment and demanded that Salomon increase his allocation. On at least one occasion, Sullivan increased his "take" of IPO share profits by receiving a significant cut of the profits that Ebbers had made from his allocation. One example in which all of the foregoing occurred was the Rhythms IPO on April 6, 1999.

292. In its August 30, 2002 response to the subpoena issued by the House Financial Services Committee, Citigroup stated that Sullivan and his wife were allocated 7,000 shares of the Rhythms IPO. While technically accurate, Citigroup's response to Congress obscured the fact that Salomon had in fact allocated only 2,000 shares to Sullivan prior to the opening of the IPO, and had provided Sullivan with an additional 5,000 shares after the stock had begun trading in the

secondary market at a price approximately 50% higher than the IPO price of $21 per share. According to a former Salomon broker who spoke with Sullivan on the date the Rhythms IPO opened, Sullivan complained that his 2,000 share allotment was insufficient and insisted that it be increased. The broker immediately placed a call to Salomon's IPO manager in New York, who authorized the additional 5,000 shares be placed in Sullivan's account.

293. Sullivan also received a payment from Ebbers in connection with the Rhythms IPO. At some point after that IPO, a former Salomon broker who handled Sullivan's brokerage account learned that a check submitted for deposit into Sullivan's account had been rejected because it was a third party check. The check at issue was drawn on a personal checking account of Ebbers, made out to Sullivan for a six-figure number, and endorsed by Sullivan, with a handwritten annotation, "Rhythms," on the memo line on the check. When the broker called Sullivan to explain that Salomon did not accept third party checks, Sullivan "went ballistic," according to the broker, and asked whether the broker wanted him (Sullivan) to tell Ebbers that Salomon was not accepting Ebbers' check. The broker said he would make inquiries within Salomon about making an exception concerning this check. The broker spoke with his supervisor, received permission to accept the Ebbers check, and so informed Sullivan. At some point in the discussion regarding the check, the broker asked Sullivan about the "Rythms" annotation on the check's memo line; Sullivan stated that the check was "part of the profits Bernie is sharing with me on that IPO."

294. According to that same broker, he subsequently processed another three to six similar checks, made by Ebbers to Sullivan, for six- and seven-figure numbers. None of those checks had an annotation on the memo line. With regard to at least two of those checks, Sullivan told the broker that the checks were a "bonus" from Ebbers.

ADDITIONAL FACTS REGARDING SCIENTER OF CERTAIN DEFENDANTS

Ebbers

295. In addition to the facts alleged above, the foregoing further demonstrates Ebbers' scienter. As reported in Business Week on September 23, 2002, Ken Johnson, a spokesman for the United States House of Representatives Energy and Commerce Committee, which continues to investigate WorldCom, noted that review of evidence "led the Committee to think Bernie Ebbers is up to his eyeballs in this [WorldCom accounting fraud.]" In addition, spokespersons for the House Committee on Financial Services, which is also investigating WorldCom's accounting fraud, stated that Sullivan told WorldCom's internal investigators that "Ebbers was aware that hundreds of millions of dollars had been moved" into capital expenditures accounts that would not impact the Company's earnings. Defendant Ebbers had an opportunity to refute these allegations on July 8, 2002 when he testified before Congress. Instead, Ebbers refused to testify, invoking his Fifth Amendment right not to incriminate himself, which is further compelling evidence in this civil case of his culpability.

296. The following facts demonstrate that Ebbers actively participated in orchestrating the fraud:

(a) As described in detail in ¶99, before the Company announced its results for the fourth quarter of 2000, Ebbers, Sullivan and Beaumount had dinner with Bosley during which Bosley agreed to help defendants cook WorldCom's books by "do[ing] whatever [was] necessary" to get WorldCom's margins back in line.

(b) Former high level executives of WorldCom confirm that Ebbers knew exactly when and how WorldCom's accounting would be manipulated. As reported by Business Week, one of WorldCom's former executives said that at one of the senior staff

meetings in 2000, Ebbers assured the staff that WorldCom could avoid financial surprises, stating that: "We won't have to worry about earnings for years" because, if necessary, the Company would tap into cash reserves to boost the revenue.

(c) Ebbers' knowledge of WorldCom's fraudulent accounting practices and his intent to disguise the fraud can be also inferred from the fact that, according to the minutes of March 6, 2002 meeting of WorldCom's Audit Committee, Ebbers sought to slash internal audit's budget by half.

(d) Finally, the sheer magnitude of the fraud clearly indicates that Ebbers, who news reports have stated was a "hands-on" manager who kept a very close eye on expenses, and whose office adjoined Sullivan's, had to know about the fraud that so far amounts to over $7 billion. As observed by The Wall Street Journal on July 1, 2002, it is inconceivable that a CEO with that kind of an eye for numbers and expenses would have missed improper transfers of billions of dollars on his own company's books.

297. Additional evidence of scienter can also be inferred from circumstances relating to Ebbers' various loans. During the years 2000 and 2001, as WorldCom's stock price was declining, WorldCom's Board of Directors loaned Ebbers over $400 million to allow Ebbers to cover margin calls on his personal loans secured by WorldCom's stock. These loans were in addition to the loans Travelers made which are discussed above. As recently reported by the media, this was the largest amount loaned by a company to its officer in history. In total, during the Class Period, Ebbers owed more than $900 million in loans -- all of which was secured by his WorldCom stock. Since Ebbers secured the loans from WorldCom using his holdings of WorldCom stock, he was under tremendous pressure to continue WorldCom's accounting fraud and maintain WorldCom's inflated stock price. Indeed, the entire Board and senior management of WorldCom felt enormous pressure

to report strong earnings because of Ebbers' margin calls. On July 1, 2002, The Wall Street Journal reported that a person close to Sullivan said that "throughout 2001 and 2002, you had a horrible, miserable environment because the CEO was margined out of his mind. Pressure was there." The following paragraphs describe in more detail the events leading to Ebbers' loans from WorldCom, as approved by the entire WorldCom Board.

(a) In September 2000, the price of WorldCom stock dropped, and Ebbers was faced with having to sell shares to cover margin calls. Ebbers entered a contract to sell some of his WorldCom shares, but as he explained to Fortune magazine, "[t]he day after I entered into a contract to sell the shares, the stock went down . . . . [T]he board said, 'Wait a minute. We don't expect our shareholders to get penalized because you got a margin call.' And so the board stepped into the gap." The WorldCom Board stepped in on September 8, 2000, by initially loaning $50 million to Ebbers.

(b) Two months later, Ebbers was again faced with additional margin calls. Accordingly, on November 1, 2000, the Board loaned Ebbers an additional $25 million on the same terms as the $50 million September loan, which had been fully exhausted by then. By November 14, 2000, Ebbers had used $11.5 million of this second loan. On December 29, 2000, WorldCom loaned Ebbers another $25 million, bringing the total amount of his indebtedness to the Company to $100 million by the end of 2000. These loans were secured not by real property or other tangible assets, but by Ebbers' holdings in WorldCom.

(c) Also in December 2000, Ebbers was facing the possibility of defaulting on a $150 million loan extended earlier in 2000 by Bank of America -- the "Administrative Agent" for WorldCom's $7 billion 364-day revolving credit facility, and for which Banc of America Securities LLC was "Sole Lead Arranger and Book Manager." Ebbers' Bank of

America debt had also been secured with his shares of WorldCom stock. In December 2000, the Board agreed to guarantee Ebbers' indebtedness together with any related interest, attorneys' fees or costs owed from time to time by Ebbers to Bank of America, in the amount of $150 million. Thus, by the end of 2000, WorldCom was on the hook for $250 million in loans to Ebbers, all of which was secured by Ebbers' WorldCom stock.

(d) In February 2002, WorldCom agreed to loan Ebbers an additional $65 million, and also agreed to repay all of Ebbers' debt to Bank of America, which the Company had guaranteed. In early February, WorldCom made an aggregate payment to Bank of America of $198.7 million, and deposited an additional $36.5 million to collateralize a letter of credit. The $165 million that the Company loaned to Ebbers was loaned at the same floating interest rate that WorldCom paid on its multi-billion dollar revolving credit agreements -- meaning that WorldCom loaned the money to Ebbers at cost. As of April 29, 2002, the interest rate on Ebbers' outstanding debt was 2.32%. (By way of comparison, for internal accounting purposes, the Company charged MCI an interest rate of 8.4% for internal debt owed.) Furthermore, if Ebbers were an average consumer, the publicly available interest rate available in Mississippi for a personal loan in 2002 ranged from 9.75% to 17.17%.

(e) With regard to the guarantees, Ebbers' obligations to Bank of America would have become due and payable upon default, "which includes, among other things, Mr. Ebbers ceasing to be [WorldCom's] President and Chief Executive Officer or any materially adverse change in his compensation package from [WorldCom]." Thus, if the board took action against Ebbers for his wrongdoing, the Company would have had to immediately pay up on its guarantee of $150 million to Bank of America and the additional

margin debt. Effectively, throughout 2001, not only was the Company on the hook financially for Ebbers, but both the Board and Ebbers were under tremendous pressure to maintain an inflated stock price.

298. Additional evidence of scienter can also be inferred from circumstances relating to Ebbers' disguised sales of his WorldCom stock through hedging transactions. Although, as described in ¶¶ 145 through 147 above, in the Fall of 2000 the Company was publicly touting to investors that WorldCom was in excellent financial and operational condition, Ebbers' actions revealed a different story. In early fall of 2000, after government officials blocked WorldCom's merger with Sprint, Ebbers effectively sold approximately $70 million of WorldCom's stock. Ebbers structured the transaction as a forward contract to disguise the obvious implications on WorldCom share price if he, the visionary CEO, dumped several millions of WorldCom shares on the market immediately following the collapse of this deal.

299. Specifically, on September 28, 2000, Ebbers entered into a contract with Banc of America Securities, LLC for the sale of three million WorldCom shares for a prearranged price of $70,597,974 (the "Forward Sale Contract"); the exchange of money and shares was to occur on April 3, 2002. The Forward Sale Contract provided that Ebbers would be paid approximately $23.54 per share, whereas the closing price for WorldCom shares on the date of the contract was $27.87.

300. When Ebbers entered into the Forward Sale Contract, he was facing massive margin calls, which as set forth above caused the Company to enter into a promissory note on September 8, 2000 for $50 million -- the first of several such notes -- in lieu of Ebbers selling his own shares to cover these margin calls. Although Ebbers had the peace of mind that he would have approximately $71 million in his pocket by 2002, Ebbers could have sold these shares on

September 28, 2000 and obtained an additional $13 million (though that sale would have had to be publicly disclosed). Moreover, he could have used the approximately $84 million proceeds of a straight sale of his three million shares to pay off his margin debts rather than repeatedly borrow money from the Company. However, Ebbers accepted this loss because (1) WorldCom's share price would have further dropped on news that the CEO sold so many shares, therefore triggering more margin calls which Ebbers knew he could not pay, and (2) he knew that WorldCom's share price would ultimately be unsustainable. As a result, Ebbers locked in a sure $71 million to protect himself once the stock price dropped while, at the same time, he sought to protect the inflated value of WorldCom's stock by avoiding a disclosable sale on that open market.

Sullivan

301. With respect to Sullivan, numerous documents and facts uncovered in the course of various investigations show that he not only knew about WorldCom's accounting fraud, but that he was its quarterback. Specifically:

(a) In his "white paper" attached as exhibit to the WorldCom's Revised Statement Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934, filed with the SEC on July 8, 2002, Sullivan admitted he knew that line costs were accounted as capital expenses rather than operating expenses.

(b) As described in more detail in ¶ 96, Brabbs specifically informed WorldCom senior executives that at least $34 million of operating expenses had been fraudulently capitalized in the Company's consolidated financial statements. In response, the U.S. executives told Brabbs that the entry was made at Sullivan's request.

(c) As further described in ¶¶ 91 through 95, Yates and Myers stated that Sullivan instructed them to make fraudulent entries in WorldCom's general ledger after

Sullivan determined that the expenses for the third and fourth quarter of 2000 were too high, and that as a result the Company would otherwise miss Wall Street's earnings expectations. Thus, the fraudulent entries were specifically designed by Sullivan to reduce the Company's operating expenses and boost earnings.

(d) In May, 2002, Sullivan attempted to delay or even stop Cynthia Cooper's internal investigation of the fraud.

(e) Sullivan sold almost $18.1 million worth of WorldCom's shares.

302. As described in more detail in ¶¶ 91 through 95, on August 28, 2002, Sullivan was charged in the Indictment with seven felonies relating to WorldCom's accounting fraud. The Indictment describes a variety of the intentional and deliberate actions taken by Sullivan to orchestrate the biggest accounting fraud in history.

303. Although Sullivan had an opportunity to refute the charges of his involvement in WorldCom's accounting fraud when he testified before Congress on July 8, 2002, he refused to do so, and invoked his Fifth Amendment right not to incriminate himself.

Myers and Yates

304. With respect to defendants Myers and Yates, on September 26, 2002 and on October 8, 2002, respectively, they pleaded guilty to, among other things, intentionally and knowingly committing securities fraud at WorldCom.

Sidgmore

305. As described in more detail in ¶ 338 below, at least as of October 2000, defendant Sidgmore knew that WorldCom was in serious financial trouble and that Sullivan was engaging in accounting tricks to meet the analysts' expectations. Although these facts were specifically brought

to Sidgmore's attention, he failed to further inquire about Sullivan's accounting decisions and about how WorldCom managed to make its numbers for that and subsequent quarters.

Kellett

306. As recently reported by The Wall Street Journal, Kellett and Ebbers struck several of their own quid pro quo transactions. For example, in 2000, Kellett, who was the Chair of the Compensation Committee of the Board, persuaded the Board to grant Ebbers several loans that ballooned to over $400 million to cover Ebbers' personal indebtedness. In return, WorldCom leased Kellett a corporate jet for $1 per month, a cost that should have been closer to $1 million annually. The Monitor appointed in the WorldCom bankruptcy, who recently scrutinized Kellett's corporate jet lease, has called for Kellett's resignation as a result of this abuse of his position. In addition, the Monitor observed that the use of the jet may have influenced Kellett's approval of a favorable severance package for Ebbers.

307. Kellett is also being investigated for several forward sales of WorldCom's stock in November 2000. At that time, apparently realizing that WorldCom's financial prospects were dim after the collapse of the Sprint deal, Kellett, under disguise of a forward contract, sold four million shares, representing approximately 67% of his and his affiliated entities' total holdings of WorldCom stock, which guaranteed that he would receive $53,566,847 in November 2003.

308. According to a Form 4 filed on December 8, 200, Kellett's arrangement with AIG Financial Services Corp. required him to deliver four million shares at an average price of approximately $13.39, whereas the closing trading price on the contract dates of November 3, 2000 and November 10, 2000 was $17.30 and $14.90 respectively -- an average of $16.10. Accordingly, Kellett passed up approximately $10.8 million in additional payment that was available if he sold his shares in the open market rather than pursuant to the forward sales contract. This was, however,

a hedge against the collapse of the share price that, since it was structured as a forward contract, avoided the negative market reaction to such a large sale by an insider.

309. In addition, on December 4, 2001, Kellett sold 50% of his holdings in WorldCom for $11.9 million.

Bobbit, Allen, Areen and Galesi

310. Bobbit, Allen, Areen and Galesi were all members of the Audit Committee of the Board during the relevant time period. The size of WorldCom's restatement alone establishes that these defendants either knew about the accounting improprieties or recklessly disregarded information which would have led them to discover the fraud. As pointedly observed by one of the accounting specialists interviewed by The Wall Street Journal on June 16, 2002, the WorldCom debacle "shows a breakdown in the chain of responsibility . . . . From [Anderson] WorldCom's longtime auditor to top management and the audit committee, all of these guys have to be responsible."

311. The SEC has stated that "[a]udit committees play a critical role in the financial reporting system by overseeing and monitoring management's and the independent auditor's participation in the financial reporting process. Audit committees can, and should, be the corporate participant best able to perform that oversight function." See Audit Committee Disclosure, Exchange Act Release No. 34-42266, 71 SEC Docket 787, 1999 WL 1244029, at *3 (Dec. 22, 1999) (emphasis added).

312. The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, which was sponsored by the New York Stock Exchange and the NASD, specifically stated that an audit committee's oversight function includes the responsibility for ensuring that the

corporation has internal controls in place specifically to deter management fraud. As the report issued by that Committee provides:

> [S]uch oversight includes ensuring that quality accounting policies, internal controls, and independent and objective auditors are in place to deter fraud, anticipate financial risks and promote accurate, high quality and timely disclosure of financial and other material information to the board, to the public markets, and to shareholders. (Emphasis added).

313. WorldCom's SEC filings represented that the members of the Audit Committee performed the following functions: review of periodic financial statements; communication with independent accountants; review of the Company's internal accounting controls; and recommendation to the Board of Directors as to the selection of independent accountants.

314. However, as reported by The Washington Post on August 29, 2002, WorldCom's internal accounting controls were virtually non-existent. Indeed, as described in detail in ¶¶ 102 through 104 above, the minutes of a June 6, 2001 Audit Committee meeting show that the Audit Committee became aware, at least as early as June 2001, that there were systemic and material deficiencies in WorldCom's internal controls. At that meeting the Audit Committee was informed that sales personnel were improperly moving accounts from one billing system to another to generate phony sales and hence higher commissions -- stemming from the use of separate billing systems for the old MCI accounts and the old WorldCom accounts, even years after that merger was completed -- resulting in the reporting of higher revenues than was appropriate. Yet the Audit Committee failed to correct these practices, and failed to take any steps to improve WorldCom's controls.

315. Further evidence of the scienter of the Audit Committee defendants is the fact that, in the proxy statement WorldCom filed on April 22, 2002 – only two months before the massive fraud was revealed – these defendants insisted that a disclaimer be included in which they

purported to disavow any and all responsibility for WorldCom's financial statements, internal controls, and even whether the Company's auditor was independent. To wit:

> The members of the audit committee are not professionally engaged in the practice of auditing or accounting and are not experts in the fields of auditing or accounting, including in respect of auditor independence. Members of the audit committee rely without independent verification on the information provided to them and on the representations made by management and the independent auditors. Accordingly, the audit committee's oversight does not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or appropriate internal control and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the audit committee's considerations and discussions referred to above do not assure that the audit of our financial statements has been carried out in accordance with generally accepted auditing standards, that the financial statements are presented in accordance with generally accepted auditing standards, that the financial statements, are presented in accordance with generally accepted accounting principles or that our auditors are in fact independent.

316. Galesi's scienter is further demonstrated by the fact that on January 30, 2002, only two weeks before WorldCom announced a massive write off of goodwill, he sold 2.9 million of WorldCom's shares, which constituted approximately 63% of his total holdings, realizing proceeds of approximately $27 million.

The Andersen Defendants

317. As described in more detail in ¶ 96, Brabbs, a senior executive in WorldCom's UK office, specifically notified Andersen and Andersen UK on at least two occasions in 2000 that WorldCom's management was making fraudulent entries in WorldCom's financial records relating to expenses. Thus, Andersen UK and Andersen had actual knowledge of the fraudulent acts that ultimately caused the restatement – namely, the fraudulent capitalizing of normal operating expenses. Despite this knowledge, Andersen failed to inquire into WorldCom's accounting

practices relating to this particular entry, which remained improperly accounted for until after Andersen was removed and replaced as WorldCom's auditor in May 2002.

318. Andersen's scienter is further demonstrated by the fact that the accounting fraud at WorldCom was enormous -- yet strikingly simple to detect by an auditor bringing appropriate professional skepticism to his or her audit engagement. As observed by one of the accounting experts interviewed by The Wall Street Journal, "[t]his is basic stuff." Indeed, during the Congressional hearings on the WorldCom debacle on the July 8, 2002, Bert Roberts, the chairman of WorldCom's Board of Directors, observed that "the failure of our outside auditors to uncover them [the accounting irregularities] is inconceivable." Dick, one of Anderson's audit partners in the relevant period, declined to respond to questions regarding how Andersen's audit activities could have failed to discover the transfers. Indeed, there are reports by persons close to WorldCom that there are additional documents suggesting that Andersen actually reviewed and approved the Company's accounting of line costs.

319. Although Andersen had stated that it was not consulted or notified about the line cost capitalization, a fundamental requirement of any auditor is to look at material expenditures and make sure they are reported properly. The growth of the Company's capitalized expenses should have informed Andersen, had it been performing its duties properly and in conformity with auditing standards, that this item was materially overstated and, concomitantly, that the Company's expenses were materially understated. In addition, auditors for capital-intensive businesses like telecommunication companies must look for improper capitalization since capitalized accounts are subject to such simple abuses. Since a chief financial officer can potentially override the accounting system of any company, auditors look at capital expenditures and make sure there is proof of such transactions.

320. Further, as a part of the audit process, Andersen was required to determine whether management had adequate controls to prevent a material error in the financial statements as a result of failure to properly capture transactions, process data, and record date in the general ledger. It is obvious that Andersen either intentionally or recklessly failed to do it, because, as noted above and as reported by WorldCom's former employee, WorldCom had virtually "no inventory controls, no fraud controls, no nothing."

321. Finally, it has been reported that Andersen specifically audited line costs expenses and, either intentionally or recklessly, observed that as a percentage of revenue such costs remained flat on a year to date basis.

Summary of Overstatements

322. To date, the total admitted overstatements of WorldCom's reported pretax income is $7.683 billion, as set forth below:

1999 (year)	$209 million
2000 (year)	$3.257 billion
2001 (year)	$3.382 billion
2002 (first quarter)	$835 million

323. To date, WorldCom has not filed restated financial statements for 1999, 2000, 2001 and the first quarter of 2002.

324. On September 19, 2002, The Wall Street Journal reported that WorldCom was preparing to announce an additional restatement of approximately $2 billion to its financial results.

WORLDCOM'S VIOLATIONS OF GAAP

WorldCom's Improper Reduction of Reserves

325. Beginning at least by October 2000, WorldCom made entries in its general ledger artificially reducing line cost expense and, in amounts corresponding to the line cost expense, drawing down from various reserve accounts. There was no supporting documentation or business rational for these entries. WorldCom has now admitted that it reduced line cost expense in this manner by $828 million in the third quarter 2000 and $407 million in the fourth quarter 2000, which increased WorldCom's reported pretax earnings for 2000 by $1.235 billion. This was accomplished by reducing various reserve accounts without supporting documentation in clear contravention of GAAP.

WorldCom's Improper Capitalization of Expenses

326. On June 25, 2002, WorldCom announced that it intended to restate its financial statements for 2001 and the first quarter of 2002 because "certain transfers from line cost expenses to capital accounts during this period were not made in accordance with [GAAP]." WorldCom admitted that $3.8 billion in line-cost operating expenses, that should have been expensed as incurred, were in fact capitalized as assets, thereby overstating WorldCom's earnings and its cash flows from operations.

327. GAAP provides that expenses are recognized when benefits are used up in delivering services. FASB Statement of Concepts ("Concepts") No. 5, 85. Assets are recorded only when there is a probable future economic benefit anticipated from a cost. Concepts No. 6, 25. Here, however, WorldCom had expressly admitted that it violated these central GAAP requirements.

328. WorldCom's announcement that it was restating its financial statements for 2001 and the first quarter of 2002 constitutes an admission that the financial statements issued for each of the quarters in 2001 and for the first quarter of 2002, as described above, were false and that the overstatements of income were material. GAAP provides that financial statements should only be restated in limited circumstances; that is, when there is a change in the reporting entity, there is a change in accounting principles used, or to correct an error in previously issued financial statements. WorldCom's restatements were not due to a change in reporting entity or a change in accounting principles, but rather to correct errors in previously issued financial statements. Therefore, the restatements are admissions by WorldCom that its previously issued financial results and its public statements regarding those results were materially false.

329. SEC Regulations require that financial statements filed with the SEC conform to GAAP requirements. Financial statements that are not prepared in conformity with GAAP are presumed to be misleading or inaccurate. 17 C.F.R. §210.401(a)(1). The Company's financial statements referred to above were false and misleading for the reasons alleged herein and because they constituted an extreme departure from GAAP by violating the following GAAP concepts and principles, among the many other principles identified above:

(a) the concept that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions (FASB Statement of Financial Accounting Concepts No. 1);

(b) the concept that financial reporting should provide information about an enterprise's financial performance during a period (FASB Statement of Financial Accounting Concepts No. 1);

(c) the concept that financial reporting should be reliable in that it represents what it purports to represent (FASB Statement of Financial Accounting Concepts No. 2);

(d) the concept of completeness, which means that nothing material is left out of the information that may be necessary to ensure that it validly represents underlying events and conditions (FASB Statement of Financial Accounting Concepts No. 2);

(e) the concept that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered (FASB Statement of Financial Accounting Concepts No. 2);

(f) the principle that if no accrual is made for a loss contingency, then disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred (FASB Statement of Financial Accounting Concepts No. 5);

(g) the principle that contingencies and other uncertainties that affect the fairness of presentation of financial data at an interim date shall be disclosed in interim reports in the same manner required for annual reports (APN Opinion No. 28);

(h) the principle that disclosures of contingencies shall be repeated in interim and annual reports until the contingencies have been removed, resolved, or have become immaterial (APB Opinion No. 28);

(i) the principle that management should provide commentary relating to the effects of significant events upon the interim financial results (APB Opinion No. 28); and

(j) the concept that an expense or loss is required to be recognized if it becomes evident that previously recognized future economic benefits of an asset have been reduced or eliminated, or that a liability has been incurred or increased, without associated economic

benefits (FASB Statement of Financial Accounting Concepts No. 5).

WorldCom's Excessive Acquisition Write-offs

330. During the time it was rapidly expanding by making acquisitions, WorldCom consistently recorded excessive "one-time" write-offs and established excessive reserves in connection therewith. Such reserves were artificially inflated and were then used to secretly increase reported operating earnings in later quarters by drawing down on and reducing/reversing those reserves. This deceptive practice was successfully hidden because users of the financial statements often expect an acquiring company to establish and record large reserves in connection with major acquisitions. Further, since such items are seen as non-recurring, they normally do not have a negative impact on the trading price of the acquirer's securities. Thus, WorldCom was able to create and record excessive, unduly large write-offs of reserves each time it did an acquisition without any adverse impact on the price of its securities. The Company would then "draw down" on these excessive reserves (which were inflated to begin with) in later quarters, which had the effect of boosting reported operating results, without disclosing this artifice. This accounting manipulation and material omission gave a misleading impression of the strength of WorldCom's operations and its ongoing earnings power by artificially inflating its reported results.

331. WorldCom frequently characterized these excess acquisition charges as "in process research and development costs" or other merger-related costs. As noted in Business Week, "Ebbers took huge write-offs associated with acquisitions, enabling him to pump up future earnings."

332. WorldCom also inflated its earnings by improperly misclassifying assets in connection with acquisitions. For example, WorldCom acquired MCI in September 1998 in a transaction accounted for as a purchase. As is customary in purchase accounting, all of MCI's

assets and liabilities were revalued at the time of the acquisition to their fair market values and then combined with WorldCom's assets and liabilities. To reflect this "fair value," WorldCom reduced the book value of MCI's property, plant, and equipment ("PP&E") by $3.4 billion to $10.7 billion from the pre-acquisition balance of $14.1 billion. Goodwill was commensurately increased by the $3.4 billion reduction in PP&E. This manipulation inflated WorldCom's earnings during the period from 1999 to 2001 since goodwill is amortized over a longer period than the average of 4.3 years for PP&E. Thus, the shorter-lived PP&E assets were converted into significantly longer-lived assets, artificially inflating WorldCom's subsequently reported earnings through less annual amortization expense. This manipulation increased WorldCom's 1999, 2000 and 2001 annual pre-tax earnings by $695 million by reducing the Company's reported annual amortization/depreciation expense by that amount.

333. WorldCom's financial statements were also false and misleading throughout the Class Period due to its failure to record impairment in the value of goodwill on its balance sheet. WorldCom disclosed in its Form 10-Q for the first quarter 2002 that, based on preliminary analysis, it planned to reduce goodwill by $15 to $20 billion. The Company's management attributed the reduction to adoption of SFAS No. 142, which became effective in fiscal years after December 31, 1991.

334. However, the true amount of the required write-down was $50 billion, as the Company admitted in August 2002, when it disclosed that write-down of its goodwill and other intangibles would be taken. Indeed, the excuse given by WorldCom management in the first quarter 2002 Form 10-Q -- that the goodwill write-down resulted from a change in accounting standards -- was itself false and misleading. In actuality, the conditions that required the write-

down existed well before SFAS No. 142 became effective, and the full $50 billion write-down was required under the long-standing SFAS No. 121.

335. The foregoing failures violated Section 13(b)(2) of the Exchange Act which requires WorldCom management to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." In addition, by failing to periodically review and write down goodwill and intangible assets, on a timely basis and in appropriate amounts, defendants also breached a duty imposed by GAAP as set forth in FASB Statement of Standards No. 121, ¶¶ 5 and 6, which requires the reevaluation of values of assets upon the occurrence of events or changes in circumstances that indicate that the recoverability of the carrying amount of an asset should be assessed, including:

(a) a significant decrease in the market value of an asset;

(b) a significant change in the extent or manner in which an asset is used or a significant physical change in an asset;

(c) a significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator;

(d) an accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset; and

(e) a current period operating or cash flow loss combined with a history of operating or cash flow losses associated with an asset used for the purpose of producing revenue.

336. Widely publicized problems in the telecommunications industry and in WorldCom's acquired business should have indicated to WorldCom's management -- as well as Andersen, Salomon and each of the Underwriter Defendants -- long before the admission that WorldCom's

goodwill and other intangibles were being carried at values that were materially inflated and not supportable by any acceptable accounting practices. However, defendants failed to review the value of WorldCom's goodwill and intangibles in connection with the Note Offerings or on any sort of periodic basis, and to adjust and write down the carrying value of the Company's goodwill and intangibles in order to: (a) inflate WorldCom's share price by reporting artificially high and materially misleading earnings; (b) allow WorldCom to complete the SkyTel and Intermedia acquisitions during the Class Period; and (c) allow WorldCom to undertake its much-needed Note Offerings, while its debt securities were still rates as "investment grade."

WorldCom's Lack of Controls

337. On August 29, 2002, The Washington Post published an article entitled "Fast and Loose at WorldCom - Lack of Controls, Pressure to Grow Set Stage for Financial Deceptions." The article was based on a review of thousands of pages of previously undisclosed documents that the Post had obtained, along with interviews with former employees and people familiar with WorldCom's operations. According to the article:

(a) In the years before WorldCom announced the restatement, WorldCom was plagued by loose business practices, inadequate financial disclosure, and "widespread internal chicanery and corruption." Among other things, WorldCom booked orders for services or equipment even if they were not provided, so that departments could meet their revenue targets. Further, employees routinely falsified sales in order to boost their commissions.

(b) In early 2002, WorldCom announced that it had fired a number of employees in its Pentagon City, Virginia office for improperly booking sales to inflate their commissions. Although the Company denied that this was a widespread problem, the

minutes of a June 6, 2001 meeting of the Company's Audit Committee belie this assertion. At that meeting, Cooper (who ultimately revealed the line cost fraud) reported that numerous "accounts that moved from one billing system to another resulted in commission overpayments." In all, "292 accounts had been moved over a year's period," resulting in overpayment of commissions of $930,000. Moreover, according to one former WorldCom employee, Senior Vice President for Sales Deborah Surrette ("Surrette") told the internal audit staff that the scam involved "many more employees, including a vice president, and significantly more money."

(c) In May 2001, an employee faxed an anonymous note to Surrette and Chief Operating Officer Ron Beaumont identifying several instances of improper billing by a manager in order to inflate commissions. The employee wrote that "[t]here are a lot more instances of things like this going on. Just ask around and you will find out." Similarly, on February 20, 2002, an employee told an internal auditor that two network circuits were billed and recorded even though the customer never got access to the circuits and the order was later cancelled. According to the email, which was sent to Cooper, Sullivan and Ebbers, this occurred "because Ms. Surrette needed MonRev [monthly revenue] credit."

338. The documents obtained by The Washington Post also showed that, in October 2000 -- only days before the Company was set to announce its results for the 2000 third quarter -- a small group of WorldCom executives, including then Vice-Chairman John Sidgmore, was well aware that WorldCom's business was eroding rapidly and discussed various accounting maneuvers that would help prop up the Company's bottom line. Summarizing an email exchange over two days that began on Oct. 21, the article stated:

> Sullivan told then-Vice Chairman Sidgmore that the company was in a "really scary" situation of escalating costs and declining revenue

> growth in certain key areas. Just two months earlier, Sullivan had sold stock worth $18 million.
>
> He told Sidgmore, for instance, that revenue from one of the company's biggest customers, America Online, was growing by only 1 percent, in part because its Internet traffic growth had slowed and much of the data was being carried on lines leased, not owned, by WorldCom.
>
> "Wow! I had no idea that the revenue growth had deteriorated that much," Sidgmore wrote back, adding that "it's going to take some pretty fancy explaining."
>
> Sullivan agreed, telling Sidgmore he would be making some accounting changes that would result in better margins for certain parts of the business. Sullivan said he would be taking two sources of revenue totaling about $225 million - in one case certain fees and in another case some equipment sales - and reclassifying them as cost reductions.

339. WorldCom announced its third quarter results on October 26, 2000, and touted "solid" results with a 12 percent increase in overall revenue. The adjustments, which Edward Soule, a professor of corporate ethics at Georgetown University and a CPA, has called "baldly manipulative" enhanced the Company's operating margin, a key statistic for Wall Street. Despite what defendants knew about the true state of WorldCom's business, on the conference call following the announcement, an upbeat Ebbers told analysts that the Company was "a very good bargain out there in the market today." This was the same quarter in which Sullivan began directing WorldCom employees to use Company reserves to offset operating costs by $828 million, thereby increasing the Company's earnings by the same amount.

340. Moreover, the most basic systems to control costs were either absent or ineffective. Documents showed that the sales division was not responsible for how much it cost to bring in business -- in other words, it was acceptable to sign a contract to provide a data network for $1 million, even if it cost $2 million to fulfill the order. According to a 2001 internal audit report,

"groups purchase new equipment without verifying whether the equipment is already in inventory. The purchasing system does not require that inventory be checked . . . In December 2000, $10 million in new equipment purchases was processed without inventory review. A sample of these purchases indicated unnecessary spending of $2 million to $3 million . . . on fiber patch cords alone."

341. These problems were exacerbated by WorldCom having become, by 2000, a conglomeration of the more than 60 telecommunications companies it had acquired. Internal documents and current and former WorldCom employees confirm how poorly WorldCom had integrated these companies, doing little if anything to integrate them to eliminate overlapping costs. As Tony Minert explained in an email to Myers and Yates on July 20, 2000, "there seems to be no regard for cost. This will continue in the future until we make people accountable for their actions."

342. WorldCom has since announced that it expects to write-off all existing goodwill and other intangible assets, which had been recorded as $50.6 billion, which means that WorldCom's assets were wildly overstated during the Class Period. The Company is also reevaluating the carrying value of existing property, plant and equipment as to possible impairment of historic values previously reported.

FRAUD-ON-THE-MARKET DOCTRINE

343. Plaintiffs will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine. The market for WorldCom stock and bonds was at all times an efficient market for the following reasons, among others:

(a) WorldCom's stock met the requirements for listing and was listed on the NASDAQ National Market System;

(b) As a regulated issuer, WorldCom filed periodic public reports with the SEC;

(c) WorldCom's securities volume was substantial during the period from 1999 through June 2002;

(d) WorldCom was followed by various analysts employed by major brokerage firms, including Salomon, UBS Warburg, Merrill Lynch and others, who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms and which were available to various automated data retrieval services; and

(e) The market price of WorldCom securities reacted efficiently to new information entering the market.

344. The foregoing facts clearly indicate the existence of an efficient market for trading of WorldCom stock and bonds and support application of the fraud-on-the-market theory. Similarly, Plaintiffs are entitled to a presumption of reliance with respect to the misstatements and omissions alleged in this Complaint.

CLAIMS FOR RELIEF

COUNT I

(Against the Individual Defendants Except Myers and Yates for Violations of § 11 of the Securities Act)

345. This claim is asserted on behalf of all Class members who purchased or acquired the Notes issued in the 2000 Offering and 2001 Offering. This claim does not sound in fraud, and plaintiffs do not incorporate herein any allegations of fraud in connection with this Count.

346. The Individual Defendants (other than Myers and Yates) were directors of WorldCom at the time the registration statements for the 2000 Offering and 2001 Offering became effective, and with their consent were identified as such in the registration statements. In addition, they signed the registration statements or authorized them to be signed on their behalf.

347. The prospectus and registration statement issued in connection with the 2000 Offering contained untrue statements of material fact and omitted to state material facts necessary to make the statements made therein not misleading, as set forth in ¶¶ 196 and 199 above.

348. The prospectus and registration statement issued in connection with the 2001 Offering contained untrue statements of material fact and omitted to state material facts necessary to make the statements made therein not misleading, as set forth in ¶¶ 203 and 207 above.

349. The Individual Defendants (other than Myers and Yates) are liable under § 11 of the Securities Act for the material misrepresentations or omissions contained in the registration statements. These defendants did not make a reasonable investigation and did not possess reasonable grounds for believing that the statements contained in the registration statements were true, did not omit any material fact, and were not materially misleading.

350. Certain plaintiffs and other members of the Class purchased WorldCom Notes issued in, or traceable to, the 2000 and 2001 Offerings, which were conducted pursuant to the registration statements.

351. The registration statements, at the time they became effective, contained material misrepresentations of fact and omitted facts necessary to make the facts stated therein not misleading. The facts misstated and omitted would have been material to a reasonable person reviewing the registration statements.

352. Plaintiffs did not know, and in the exercise of reasonable diligence, could not have known of the misstatements and omissions of the registration statements.

353. Plaintiffs have sustained damages as a result of the misstatements and omissions of the registration statements, for which they are entitled to compensation.

354. Plaintiffs brought this action within one year after the discovery of the untrue

statements and omissions, and within three years after the 2000 Offering and the 2001 Offering.

355. None of the misrepresentations or omissions alleged here were forward looking statements but, rather, concerned existing facts. Moreover, defendants did not properly identify any of these statements as forward-looking statements and did not disclose information, known to them, that undermined the validity of those statements.

COUNT II

(Against the Individual Defendants for Violations of § 15 of the Securities Act)

356. This claim is asserted on behalf of all Class members who purchased or acquired the Notes issued in the 2000 Note Offering and 2001 Note Offering. This claim does not sound in fraud, and plaintiffs do not incorporate herein any allegations of fraud in connection with this Count.

357. The Individual Defendants at all relevant times participated in the operation and management of the Company, and conducted and participated, directly and indirectly, in the conduct of WorldCom's business affairs.

358. As officers and directors of a publicly owned company, the Individual Defendants had a duty to disseminate accurate and truthful information with respect to WorldCom's financial condition and results of operations.

359. WorldCom has admitted that its financial statements included and incorporated in the registration statements for the Notes were materially false and misleading. This admission by itself proves WorldCom’s primary violation of Section 11 of the Securities Act with respect to the Note Offerings.

360. Because of their positions of control and authority as senior officers and directors of WorldCom, the Individual Defendants were able to, and did, control the contents of the registration

statements which contained materially false financial information. The Individual Defendants therefore were "controlling persons" of WorldCom within the meaning of § 15 of the Securities Act.

361. Certain plaintiffs and other members of the Class purchased WorldCom Notes issued in, or traceable to, the Offerings. The Offerings were conducted pursuant to the registration statements.

362. The registration statements, at the time they became effective, contained material misrepresentations of fact and omitted facts necessary to make the facts stated therein not misleading. The facts misstated and omitted would have been material to a reasonable person reviewing the registration statements.

363. Plaintiffs did not know, and in the exercise of reasonable diligence, could not have known of the misstatements and omissions of the registration statements.

364. Plaintiffs have sustained damages as a result of the misstatements and omissions of the registration statements, for which they are entitled to compensation.

365. Plaintiffs brought this action within one year after the discovery of the untrue statements and omissions, and within three years after the 2000 Offering and the 2001 Offering.

366. None of the misrepresentations or omissions alleged here were forward looking statements but, rather, concerned existing facts. Moreover, defendants did not properly identify any of these statements as forward-looking statements and did not disclose information, known to them, that undermined the validity of those statements.

COUNT III

(Against Defendant Andersen for Violations of § 11 of the Securities Act)

367. This claim is asserted on behalf of all Class members who purchased or acquired the

Notes issued in the 2000 Offering and 2001 Offering. This claim does not sound in fraud, and plaintiffs do not incorporate herein any allegations of fraud in connection with this Count.

368. Andersen was an independent chartered accountant retained by WorldCom since 1989 to audit WorldCom's fiscal 1989 through 2002 financial statements. Pursuant to that retention, Andersen issued unqualified opinions for WorldCom's financial statements for fiscal years 1999, 2000 and 2001.

369. Andersen expressly consented to having its unqualified audit opinions for WorldCom's 1999 and 2000 financial statements incorporated by reference into the registration statements for the 2000 Offering and 2001 Offering. As such, Andersen expressly consented to serve as an accounting "expert" with respect to the offering of the Notes.

370. Andersen's unqualified opinions on WorldCom's 1999 and 2000 financial statements, incorporated by reference into the registration statements, were materially false and misleading. Contrary to its representations, Andersen's audit of those financial statements had not been conducted in accordance with GAAS, and WorldCom's financial condition and results of operations had not been presented in conformity with GAAP. Instead, WorldCom's audited financial statements for the years 1999 and 2000 contained untrue statements of material fact and failed to state other facts necessary to make the statements not misleading.

371. As an accounting expert which consented to the use of its unqualified audit opinions in the registration statements, Andersen is liable under § 11 of the Securities Act for the material misrepresentations or omissions contained in its unqualified audit opinions and in WorldCom's financial statements for the years 1999 and 2000, as reported and incorporated in the registration statements. Andersen did not make a reasonable investigation and did not possess reasonable grounds for believing that its representations in its audit opinions and WorldCom's financial

statements were true, did not omit any material facts, and were not materially misleading.

372. Certain plaintiffs and other members of the Class purchased WorldCom Notes issued in, or traceable to, the Offerings. The Offerings were conducted pursuant to the registration statements.

373. The registration statements, at the time they became effective, contained material misrepresentations of fact and omitted facts necessary to make the facts stated therein not misleading. The facts misstated and omitted would have been material to a reasonable person reviewing the registration statements.

374. Plaintiffs did not know, and in the exercise of reasonable diligence, could not have known of the misstatements and omissions of the registration statements.

375. Plaintiffs have sustained damages as a result of the misstatements and omissions of the registration statements, for which they are entitled to compensation.

376. Plaintiffs brought this action within one year after the discovery of the untrue statements and omissions, and within three years after the 2000 Offering and the 2001 Offering.

COUNT IV

(Against the Underwriter Defendants for Violations of § 11 of the Securities Act)

377. This claim is asserted on behalf of all Class members who purchased or acquired the Notes issued in the 2000 Offering and 2001 Offering. This claim does not sound in fraud, and plaintiffs do not incorporate herein any allegations of fraud in connection with this Count.

378. The Underwriter Defendants served as the underwriters of the Notes and qualify as such according to the definition contained in Section 2(a)(11) of the Securities Act, 15 U.S.C. § 77b(a)(11). As such, they participated in the solicitation, offering, and sale of the Notes to the investing public pursuant to the registration statements.

379. Due to their role as underwriters of the Notes, the Underwriter Defendants were responsible for the contents and dissemination of the registration statements and are liable under § 11 of the Securities Act for any material misrepresentations or omissions contained therein. The Underwriter Defendants did not make a reasonable investigation and did not possess reasonable grounds for believing that the statements contained in the registration statements were true, did not omit any material fact, and were not materially misleading.

380. The allegations contained herein relating to WorldCom's fraudulent financial statements are replete with examples of the failure of the Underwriter Defendants to perform a reasonable investigation and due diligence in connection with the Note Offerings.

381. As alleged herein, WorldCom failed to timely write-down the significant amount of goodwill it carried on its books and financial statements, even though the value of such goodwill was impaired, in large part as a result of the vast over-capacity in, and the general downturn throughout the entire telecommunications industry. The Underwriter Defendants were aware of these problems and, given the significance of goodwill carried as an asset on WorldCom's balance sheets throughout the Class Period, in the course of their due diligence, the Underwriter Defendants should have required management to record and reflect such impairment in WorldCom's financial statements.

382. The Underwriter Defendants further failed to perform reasonable investigation in connection with their duty to fully understand WorldCom's policies with respect to recognizing revenue and recording expenses in its financial statements. Despite this requirement, the Underwriter Defendants failed to investigate that WorldCom was, throughout the Class Period, improperly capitalizing operating expenses and improperly recording revenue.

383. In particular, the Underwriter Defendants were required to do due diligence to

determine whether WorldCom was properly maintaining its infrastructure and modernizing it in accordance with the technological advancements in its industry, in order to evaluate the quality of the Company's anticipated revenue streams. Had the Underwriter Defendants performed this fundamental task, they would have learned that the Company was capitalizing nearly one billion dollars in line costs expenses each quarter. This would have become apparent because, in the normal course of events, there is no consistent pattern as to when large capital expenditures occur. To the contrary, they occur when needed and sporadically, such as when a company needs to make improvements to its physical plant, or to install new technology. However, in the case of WorldCom, each of the enormous capital expenditures being recorded occurred after the end of a quarter, in a consistent manner. Thus, had the Underwriter Defendants performed any due diligence at all with respect to WorldCom's capital expenditures, they would have uncovered the fraud.

384. In addition, had the Underwriter Defendants performed the fundamental step of comparing WorldCom's actual capital expenditures to its budgeted capital expenditures, they would have known that actual capital expenditures exceeded budgeted numbers by staggering amounts, i.e., as much as a billion dollars each quarter. This fact alone would have required the Underwriter Defendants to ask about the nature and necessity of the expenditures. Had they done so, they would have learned that there were no such expenditures, and that WorldCom had improperly capitalized ordinary expenses to make its numbers.

385. In addition, large capital expenditures usually require top executive authorization and, in many cases, approval of an executive committee or board of directors. Again, had the Underwriter Defendants done any due diligence, such diligence would have revealed enormous capital expenditures that were unapproved.

386. Further, had the Underwriter Defendants performed the rudimentary step of comparing WorldCom's revenues to the net book value of the Company's revenue producing capital assets they would have learned that such ratio was remarkably out of sync with WorldCom's competitors.

387. Finally, the very fact that the Company was managing to consistently report earnings which either exactly met, or just exceeded, analysts' expectations, while the Underwriter Defendants knew that the telecommunications industry was performing poorly, should have made the Underwriter Defendants skeptical about WorldCom's operating performance and anticipated future cash flow. As a result, the Underwriter Defendants should have performed due diligence on the quality of WorldCom's operating income. Had they done so, they would have learned that the only reason WorldCom was able to meet expectations was because it was improperly capitalizing operating expenses.

388. In performing their due diligence procedures and investigations, the Underwriter Defendants further ignored risk factors that were present and ultimately led to WorldCom's fraudulent reporting. Such "red flags," which the Underwriter Defendants had a duty to investigate, but instead ignored, included the following:

-- A significant portion of management's compensation was represented by bonuses, stock options, and other incentives, including but not limited to the millions of dollars of that Bank of America, Travelers (Salomon's corporate affiliate) and the WorldCom Board loaned to Ebbers, which were backed by Ebbers' stock in WorldCom, the value and safety of which were contingent upon WorldCom achieving unduly aggressive targets for operating results, and thereby maintaining its stock price above certain levels;

-- Excessive interest by management in maintaining or increasing WorldCom's stock price and earnings trend through the use of unusually aggressive accounting practices;

- The practice by management of committing to analysts, creditors, and other third parties to achieve unduly aggressive and clearly unrealistic forecasts, as could be seen by the Underwriter Defendants through comparisons of WorldCom's projected and reported results with the results being reported by WorldCom's major competitors;

- Domination by Ebbers, Sullivan and others in a small group without compensating controls such as effective oversight by the Board of Directors or Audit Committee, as seen, among other things, by Ebbers' and Sullivan's directive that WorldCom's internal audit division would play no role in auditing the financial statements, and by the Board's continual decisions to lend hundreds of millions of dollars to Ebbers to bail him out of his personal credit problems;

- Inadequate monitoring of significant controls;

- Management's failure to correct known reportable conditions on a timely basis;

- Unduly aggressive financial targets and expectations for operating personnel set by management;

- A high degree of competition or market saturation, accompanied by declining margins;

- WorldCom operating in a declining industry with increasing business failures and significant declines in customer demand, including, for instance, the minimal growth during the Class Period of business from America Online, a key WorldCom customer;

- Significant pressure to obtain additional capital necessary to stay competitive, including the need for funds to finance major capital expenditures, as seen, among other things, through the massive debt financings in which the Underwriter Defendants themselves played a critical role; and

- Material amounts of assets, liabilities, revenues, and expenses that were based on significant estimates that involved unusually subjective judgments or uncertainties such as ultimate collectibility of receivables, timing of revenue recognition, and significant deferral of costs.

389. Further, each of the Underwriter Defendants knew of, or but for their negligence

would have recognized, the conflicted position that Salomon -- the lead underwriter on the 2000 Offering and 2001 Offering-- had with respect to its underwriting and due diligence duties for the Offerings. As described in detail above, Salomon's relationship with WorldCom, its senior executives and certain of its Board members, was fraught with conflicts. Given the conflicts, Salomon had a duty to ensure that the other Underwriter Defendants conducted their own due diligence and investigations separate and apart from Salomon, and satisfied themselves that the registration statements for the Offerings did not contain untrue statements or fail to include material information.

390. The other Underwriter Defendants were or should have been aware of the many deals on which Salomon served as WorldCom's financial advisor; the bullish reports that Grubman published to support WorldCom's stock price; Salomon's service as the WorldCom employee stock option manager, as well as its service as broker to many of WorldCom's top executives and employees; and WorldCom's selection of Salomon as the lead underwriter for the massive Note Offerings in 2000 and 2001. As a result, each of the other Underwriter Defendants had a duty to conduct its own due diligence and investigation, separate and apart from Salomon, and to view Salomon's due diligence and investigation findings with the appropriate degree of skepticism, given Salomon's hopelessly conflicted position. And each of the Underwriter Defendants, including Salomon, had a duty to disclose Salomon's conflicted position.

391. Certain plaintiffs and other members of <u>the Class</u> purchased WorldCom Notes issued in, or traceable to, the Offerings. The Offerings were conducted pursuant to the registration statements.

392. The registration statements, at the time they became effective, contained material misrepresentations of fact and omitted facts necessary to make the facts stated therein not

misleading, as set forth above at ¶¶ 196-199 and 203-207. The facts misstated and omitted would have been material to a reasonable person reviewing the registration statements.

393. Plaintiffs did not know, and in the exercise of reasonable diligence, could not have known of the misstatements and omissions of the registration statements.

394. Plaintiffs have sustained damages as a result of the misstatements and omissions of the registration statements, for which they are entitled to compensation.

395. Plaintiffs brought this action within one year after the discovery of the untrue statements and omissions, and within three years after the 2000 Offering and the 2001 Offering.

COUNT V

(Against the Underwriter Defendants for Violations of Section 12(a)(2) of the Securities Act)

396. This claim is asserted on behalf of all class members who purchased or acquired the Notes issued in the 2000 Offering and 2001 Offering. This claim does not sound in fraud, and plaintiffs do not incorporate herein any allegations of fraud in connection with this Count.

397. By means of the Offering Memoranda, and by using means and instruments of transportation and communication in interstate commerce and of the mails, the Underwriter Defendants, through public offerings, offered and sold the Notes to certain plaintiffs and other members of the Class. As previously set forth herein, the Offering Memoranda negligently included untrue statements of material facts and negligently omitted to state material facts necessary in order to make the statements, in light of the circumstances under which they were made, not misleading.

398. In connection with and in furtherance of the Note Offerings, the Offering Memoranda were widely distributed to approximately several hundred or more individuals and/or entities, and thus the Note Offerings were a public offering. The Offering Memoranda also were

prospectuses for purposes of the Securities Act.

399. The Underwriter Defendants are sellers within the meaning of the Securities Act because they: (a) transferred title to plaintiffs and other purchasers of the Notes; (b) transferred title to the Notes to other underwriters and/or broker-dealers that sold the Notes as agents for the Underwriter Defendants; and (c) solicited the purchase of the Notes by plaintiffs and other members of the Class, motivated at least in part by the desire to serve the Underwriter Defendants' own financial interest and the interest of WorldCom, including but not limited to commissions on their own sales of the Notes and separate commissions on the sale of the Notes by non-underwriter broker-dealers.

400. The Underwriter Defendants actively solicited the sale of the Notes by participating in "road show" meetings in furtherance of the Note Offerings.

401. The Note Offerings consisted of new issues of securities, the Notes.

402. Certain plaintiffs and other Class members purchased the Notes based on the Offering Memoranda, or in the immediate wake of the Offering and traceable thereto.

403. Plaintiffs did not know of the omissions and misstatements described above when they purchased their Notes.

404. Plaintiffs brought this action within one year after the discovery of the untrue statements and omissions, and within three years after the 2000 Offering and the 2001 Offering.

405. By virtue of the foregoing, the Underwriter Defendants have violated Section 12(a)(2) of the Securities Act.

COUNT VI

(Against Defendants Ebbers, Sullivan, Myers, Yates, Kellett, Bobbitt, Allen, Areen, and Galesi for Violations of Section 10(b) of the Exchange Act and Rule 10b-5)

406. This Count is asserted on behalf of all Class members. Plaintiffs repeat and reallege each and every allegation set forth above as if fully set forth set forth herein.

407. The defendants named in this Count, in concert with others, individually and in concert, directly and indirectly, by the use of means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct that operated as a fraud and deceit upon plaintiffs; made various untrue and/or misleading statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; made the above statements with a severely reckless disregard for the truth; and employed devices, and artifices to defraud in connection with the purchase and sale of securities, which were intended to, and, during the Class Period, did: (i) deceive the investing public, including plaintiffs and other Class members, regarding, among other things, WorldCom's improper capitalization of expenses, excessive acquisition write-offs, improper revenue recognition and improper accounting for goodwill; (ii) artificially inflate and maintain the market price of WorldCom stock and debt securities; and (iii) cause plaintiffs to purchase WorldCom stock and debt securities at artificially inflated prices.

408. As more fully described in the paragraphs relating to the fraud, and the scienter of the above-identified defendants, pursuant to the aforesaid plan and course of conduct, the defendants participated, directly and indirectly, in the preparation and/or issuance of the statements and documents referred to above, including in WorldCom filings with the SEC, press releases, and registration statements. These statements and documents were materially false and misleading in

that, among other things, they misrepresented the Company's results, and failed to disclose the fraudulent accounting practices alleged herein.

409. At all relevant times, the material misrepresentations and omissions particularized herein directly or proximately caused the damages sustained by plaintiffs.

410. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, WorldCom stock and debt securities were sold in the public market, and the market prices of such securities were artificially inflated during the Class Period. In ignorance of the materially false and misleading nature of the reports and statements described above, plaintiffs relied to their detriment on the statements described above and/or on the integrity of the market prices as reflecting the completeness and accuracy of the information disseminated by the Company in connection with their purchases of the securities.

411. At the time of said misrepresentations and omissions, plaintiffs were ignorant of their falsity, and believed them to be true. Plaintiffs could not, in the exercise of reasonable diligence, have known the actual facts. Had plaintiffs known the truth, they would not have taken such action.

412. The markets for WorldCom securities were open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose the full truth about WorldCom and its financial condition, performance, and business, the securities traded at artificially inflated prices during the Class Period, reaching a high closing price of approximately $61 per share for the stock and $109.25 for the Notes, until the time the adverse information referred to above was finally provided to and digested by the securities markets. Plaintiffs purchased or otherwise acquired the securities relying upon the integrity of the market prices and market information relating to WorldCom, or in the alternative, upon defendants' false

and misleading statements, and in ignorance of the adverse, undisclosed information known to defendants, and have been damaged thereby.

413. The prices of WorldCom securities declined materially upon the various partial public disclosures of the true facts about the fraudulent and improper practices which had inflated their prices, and which material facts had been misrepresented and/or concealed as alleged herein. Plaintiffs have suffered substantial damages as a result of their purchases of the securities.

414. By virtue of the foregoing, the above-identified defendants have violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT VII

(Against the Individual Defendants for Violations of Sections 20(a) of the Exchange Act)

415. This Count is asserted on behalf of all Class members. Plaintiffs repeat and reallege each and every allegation stated above, as if fully set forth herein.

416. Plaintiffs assert this Count for violations of Section 20(a) of the Exchange Act against the Individual Defendants.

417. Through their positions of control and authority as officers and directors of the Company, the Individual Defendants were able to and did control, directly and indirectly, the content of the public statements disseminated by the Company. With knowledge of the falsity of the statements contained therein or in severely reckless disregard of the truth about the Company's financial condition and prospects, the Individual Defendants caused the false and misleading statements and omissions of material facts as alleged herein.

418. The Individual Defendants had direct involvement in the day-to-day operations of the Company, were senior officers of the Company, corporate officers with direct involvement in WorldCom's financial reporting and accounting functions, and/or were members of the Board of

Directors, including certain of the Individual Defendants who served as Chairman of the Board, Vice Chairman of the Board, and on its Audit and Compensation Committee, and therefore are presumed to have had the power to control or influence the particular transactions giving rise to the securities violations alleged herein, and exercised same.

419. WorldCom has admitted that its financial statements were materially false and misleading, as described above; that the actions to materially overstate the financial statements were intentional and knowing; and that it was done to artificially inflate the prices of WorldCom securities. These admissions prove WorldCom's primary violation of Securities 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

420. By reason of their management positions and/or control of the Board of Directors, the Individual Defendants were "controlling persons" within the meaning of Section 20(a) of the Exchange Act and had the power and influence to direct the management and activities of the Company and its employees, and to cause the Company to engage in the unlawful conduct complained of herein. Because of their executive, officer and director positions within WorldCom and control of the Board of Directors of WorldCom, the Individual Defendants had access to adverse non-public financial information about the Company and acted to conceal the same, or knowingly or recklessly authorized and approved the concealment of the same.

421. By virtue of the foregoing, the Individual Defendants have violated Section 20(a) of the Exchange Act.

422. Plaintiffs have been damaged by the violations of the Individual Defendants as described in this Count and seek recovery of damages caused thereby.

COUNT VIII

(Against The Andersen Defendants for Violations of Sections 10(b) of the Exchange Act and Rule 10b-5)

423. This Count is asserted on behalf of all Class members. Plaintiffs repeat and reallege each and every allegation set forth above as if fully set forth set forth herein.

424. Andersen, Andersen UK, Andersen Worldwide, Schoppet, and Dick, and other Andersen partners not presently known to plaintiffs (the "Andersen Defendants"), in concert with others, individually and in concert, directly and indirectly, by the use of means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct that operated as a fraud and deceit upon plaintiffs; made various untrue and/or misleading statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; made the above statements with a severely reckless disregard for the truth; and employed devices, and artifices to defraud in connection with the purchase and sale of securities, which were intended to, and did: (i) deceive the investing public, including plaintiffs, regarding, among other things, WorldCom's improper capitalization of expenses, excessive acquisition write-offs, improper revenue recognition and improper accounting for goodwill; (ii) artificially inflate and maintain the market price of WorldCom stock and debt securities; and (iii) cause plaintiffs to purchase WorldCom stock and debt securities at artificially inflated prices.

425. As more fully stated in the description of the fraud, (¶¶ 343-344), the violations of GAAP and the Andersen Defendants' scienter, pursuant to the aforesaid plan and course of conduct, the Andersen Defendants participated, directly and indirectly, in the preparation and/or issuance of the statements and documents referred to above, including in WorldCom filings with the SEC, press releases, and registration statements. These statements and documents were

materially false and misleading in that, among other things, they misrepresented, and failed to disclose, WorldCom's capitalization of expenses, excessive acquisition of write-offs, improper revenue recognition and improper accounting for goodwill, during the Class Period.

426. At all relevant times, the material misrepresentations and omissions particularized herein directly or proximately caused the damages sustained by plaintiffs.

427. The Andersen Defendants, among others, engaged in such a scheme to misrepresent the financial condition and results of WorldCom and to consummate the acquisitions and Note Offerings, and maintain and/or inflate the prices of WorldCom's stock and debt securities to, among other things, gain lucrative auditing and other consulting services from WorldCom. Specifically, the Andersen Defendants knew or should have known that WorldCom's reported annual financial results for 1999, 2000 and 2001, as filed with the SEC in WorldCom's Forms 10-K and other SEC filings, and disseminated to the investing public, were materially overstated and were not presented in accordance with GAAP, that Andersen's audits were not performed in accordance with GAAS, and, therefore, that Andersen's unqualified audit reports, as included or incorporated by reference in those annual and quarterly reports and other SEC filings, were materially false and misleading. The Andersen Defendants further knew that their reviews of WorldCom's quarterly financial statements were not conducted in accordance with the standards set by the AICPA.

428. The 1999, 2000 and 2001 10-Ks were materially false and misleading; contained untrue statements of material facts; omitted to state material facts necessary to make the statements made in those SEC filings, under the circumstances in which they were made, not misleading; and failed to adequately disclose material facts. As detailed herein, the misrepresentations contained in, or the material facts omitted from, those SEC filings included, but were not limited to, the overstatement of revenues, and the overstatement of income from continuing operations, EBITDA

and net earnings for 1999, 2000 and 2001, as well as the representations in Andersen's unqualified audit reports issued in connection with Andersen's audits of WorldCom's financial statements for those years, in which Andersen certified that (i) it had audited WorldCom's financial statements in accordance with GAAS; (ii) it had planned and performed those audits "to obtain reasonable assurance about whether the financial statements are free of material misstatement"; (iii) in its opinion, WorldCom's financial statements "present fairly, in all material respects, the financial position" of WorldCom "in conformity with generally accepted accounting principles;" and (iv) Andersen's audits provided a "reasonable assurance" for its opinions. As detailed herein, Andersen's audit reports were materially false and misleading. Andersen did not make a reasonable investigation or possess reasonable grounds for the belief that the statements described above, which were contained in the 1999, 2000 and 2001 10-Ks, and incorporated by reference in other SEC filings, were true, were without omissions of any material facts, and were not misleading.

429. The Andersen Defendants, with knowledge of the falsity and misleading nature of the statements contained in its unqualified audit reports, and in reckless disregard of the true nature of its audits, caused the heretofore complained of public statements to contain misstatements and omissions of material facts as alleged herein. As described herein, Andersen's audit of WorldCom's financial statements for 1999, 2000 and 2001 were not performed in accordance with GAAS, and, in fact, Andersen had no basis for its unqualified opinions. Andersen's unqualified reports dated March 24, 2000, March 30, 2001 and March 7, 2002, issued in connection with those audits, as included in the Form 10-Ks, in which Andersen certified, among other things, that its audits were performed in accordance with GAAS, were materially false and misleading.

430. As described above at ¶¶ 317-321, and as detailed below, the Andersen Defendants acted with scienter throughout the Class Period, in that they either had actual knowledge of the

misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true facts, even though such facts were available to them. Andersen was WorldCom's auditor, and, therefore, was directly responsible for the false and misleading statements and omissions disseminated to the public through its unqualified audit reports.

431. Andersen, as WorldCom's auditor, had unfettered access to the Company's books and records throughout the Class Period. Andersen, as a world-renowned former "Big 5" public accounting firm, had knowledge of the requirements of GAAS, and knew of the audit risks inherent of WorldCom and in its industry. In addition to the facts alleged in ¶¶ 317-321 above, the following facts, among others, indicate a strong inference that Andersen acted with scienter.

432. Andersen knew or recklessly disregarded that it had not performed its audits of WorldCom's 1999, 2000 and 2001 financial statements in accordance with GAAS, and, therefore, that its unqualified audit reports on those financial statements were materially false and misleading. Under GAAS, "[t]he auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." AICPA Professional Standards, AU § 110.02 (1998); AU § 316.05 (1997). As described herein, Andersen did not fulfill that responsibility. In fact, Andersen's audits of the financial statements were so woefully inadequate that Andersen repeatedly violated GAAS. Andersen utterly failed to perform the most fundamental of procedures to provide a basis for its unqualified reports. As described below, Andersen repeatedly and materially violated GAAS in each of those audits, failed to plan or to perform its audits to obtain reasonable assurance that WorldCom's financial statements were free of material misstatement, and, therefore, had no basis on which to state that the financial statements were presented in conformity with GAAP. For

example:

(i) Andersen Failed to Obtain Sufficient and Competent Evidential Matter. "Most of the independent auditor's work in forming his or her opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in such financial statements." AU § 326.02. "The independent auditor's direct personal knowledge, obtained through physical examination, observation, computation, and inspection, is more persuasive than information obtained indirectly." AU § 326.21. Representations from management "are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 333.02 (1998); AU § 333.02 (1997). "The books of original entry, the general and subsidiary ledgers, related accounting manuals, and records such as work sheets and spreadsheets supporting cost allocations, computations, and reconciliations all constitute evidence in support of the financial statements." "[W]ithout adequate attention to the propriety and accuracy of the underlying accounting data, an opinion on financial statements would not be warranted." AU § 326.16 (1998); AU § 326.15 (1997). Andersen violated GAAS by failing to obtain sufficient competent evidential matter. For example:

(1) Andersen failed to obtain direct evidence in connection with WorldCom's elimination or reduction of expenses through write-offs of reserves. Instead, Andersen relied largely on management's representations. As a result, during 1999 and 2000, approximately $1.2 billion of those reserves were written off directly to income without any conceptual basis

under GAAP. Andersen failed to discover that the adjustments were unsupported by documentation. In particular, Andersen failed to determine whether non-reporting-system journal entries (i.e., those entries that come from sources other than WorldCom's revenue, expense, cash receipts, cash disbursement and payroll accounting and reporting systems) were valid. Yet, it is likely that there were hundreds of inappropriate and unsupported non-recurring journal entries used to inflate WorldCom's 1999, 2000 and 2001 statements. Either Andersen failed to review WorldCom's general ledgers or asked to see any post-closing journal entries, or recklessly disregarded such journal entries made without support.

(2) Andersen further failed to obtain documentation with respect to the transfers of line costs from operating expenses to "plant, property and equipment," thereby failing to understand that approximately $3 billion in line costs were improperly eliminated from operating expenses during the year 2001. As admitted by WorldCom's former Controller, David Myers, no documentation existed for such transfers. Yet, Andersen failed to require documentation during its audit.

(3) Andersen also failed to determine whether WorldCom's general ledgers supported its financial statements. Thus, it failed to test and recognize that reversals of merger reserves were utilized, likely through "top-side" adjustments, to increase the amounts of earnings reported by WorldCom; it failed to test or determine that, as defendant Sidgmore acknowledged during 2000, WorldCom's "revenue growth had deteriorated

that much" and that it would "take some pretty fancy explaining;" and it failed to review or consider the emails that have since been disclosed that prove Worldcom's blatant manipulation of its financial statements.

(ii) Andersen Failed to Exercise Due Professional Care and Professional Skepticism. "Due professional care requires the auditor to exercise professional skepticism." This requires the auditor to "diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence." "In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest." AU §§ 230.07-09 (1998); AU § 316.16-21 (1997) (professional skepticism is required in planning and performing an audit). The auditor also "must be without bias with respect to the client since otherwise he would lack [the] impartiality necessary for the dependability of his findings." AU § 220.02. Notwithstanding these requirements, in connection with its planning and performing audit procedures concerning, among other things, merger reserves, revenue recognition, and certain other matters described herein, Andersen relied almost exclusively on representations from WorldCom management rather than on sufficient competent evidential matter. Andersen failed to exercise professional skepticism, failed to maintain an independent mental attitude and failed to exercise professional due care in the exercise of its audits.

(iii) Andersen Failed to Properly Plan and Supervise. The auditor must adequately plan its audit and properly supervise the work of associates so as to establish and carry out procedures reasonably designed to search for and direct the

existence of fraud that could have a material effect on the financial statements. AU 310,320,327. The auditor must also obtain a level of knowledge of its clients' businesses sufficient to enable it to "obtain an understanding of the events, transactions, and practices that, in his judgment, may have a significant effect on the financial statements." AU § 311.06. In connection with planning its audit procedures, Andersen violated GAAS because Andersen failed to obtain sufficient knowledge:

(1) of WorldCom's accounting and reporting systems to recognize, among other things, that the significance of post-closing adjustments and reversals of reserves certainly merited special consideration;

(2) upon which to assess the conditions under which WorldCom's accounting data, particularly manual journal entries and consolidating trial balances, were produced and processed;

(3) to properly evaluate the Company's estimates and management representations concerning, among other things, the establishment and application of merger and other reserves;

(4) to properly evaluate the Company's internal controls, which were in fact nonexistent

(5) of WorldCom's business and transactions upon which to assess the propriety of management's accounting treatment of, among other things, asset write-offs; and

(6) to properly evaluate the propriety and consistency of WorldCom's application of accounting principles notwithstanding

Andersen's knowledge that WorldCom's management and Board had determined that WorldCom's internal auditing division would provide only operational audits, and would not have any role in auditing the Company's reported financial results.

(iv) Andersen Failed to Properly Evaluate Audit Findings. "The risk of material misstatement of the financial statements is generally greater when account balances and classes of transactions include accounting estimates rather than essentially factual data because of the inherent subjectivity in estimating future events." Estimates are subject "to misstatements that may arise from using inadequate or inappropriate data or misapplying appropriate data." AU § 312.36. "Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors." Accordingly, the auditor should consider estimates "with an attitude of professional skepticism." AU § 342.04. "[T]he auditor should obtain an understanding of how management developed the estimate," AU § 342.10, and should "obtain sufficient competent evidential matter to provide reasonable assurance" that, among other things, estimates are reasonable in the circumstances and are presented in conformity with GAAP, AU § 342.07. Andersen violated GAAS, because it failed to obtain sufficient competent evidential matter concerning, and, therefore, failed to properly evaluate, WorldCom's estimates of, among other things, merger and other reserves.

(v) Andersen Failed to Properly Consider Fraud. "The auditor should specifically assess the risk of material misstatement of the financial statements due

to fraud and should consider that assessment in designing the audit procedures to be performed." AU § 316.12; AU § 316.05 ("The auditor should assess the risk that fraud may cause the financial statements to contain a material misstatement."). Among the conditions that should cause the auditor to consider that a client has attempted financial fraud are discrepancies in the accounting records, such as transactions not properly recorded as to amount, or unsupported or unauthorized balances or transactions; conflicting or missing evidential matter, such as significant unexplained items on reconciliations; or denied access to records. AU §§ 316.25, 317.09 (1998); AU §§ 316.21, 317.09 (1997). To limit the risk of financial statement misstatement as a result of fraud, the auditor should perform procedures, including a detailed review of the client's quarter-end and year-end adjusting journal entries and an investigation of any entries that appear unusual as to nature or amount and of significant and unusual transactions, particularly those occurring at or near quarter- or year-end. AU § 316.29 (1998). Andersen violated GAAS because it failed to properly consider the risk that WorldCom's financial statements would be materially misstated as a result of fraud. Andersen did not sufficiently consider that the incredible growth by acquisition strategy employed by WorldCom provided a ready-made opportunity for WorldCom to misrepresent its true financial results. Andersen also failed to recognize hundreds of unsupported and improper journal entries, including nearly $4 billion of line cost transfers, or the significance of the highly material reserve reversals.

(vi) Andersen Failed to Properly Consider WorldCom's Lack of Internal Control. "In all audits, the auditor should obtain an understanding of internal control

sufficient to plan the audit." AU § 319.02. "The auditor should obtain sufficient knowledge of the information system relevant to financial reporting to understand," among other things, the classes of significant transactions, "the accounting records, supporting information and specific accounts in the financial statements involved in the processing and reporting of transactions," the accounting processing involved in recording, processing, accumulating and reporting transactions, and the financial reporting process used to prepare financial statements. AU § 319.36. Andersen violated GAAS because it failed to learn or to consider that WorldCom had grossly deficient internal controls and procedures. For example, Andersen failed to properly consider:

(1) that WorldCom lacked any inventory or fraud controls, or other internal controls designed to protect against management fraud;

(2) that WorldCom's finance department made wholesale changes to reports from international and other operating divisions, starting at least as early as 1999, and continuing through 2001;

(3) that a significant number of consolidating entries were unsupported, unreviewed and not approved;

(4) that data and information systems were not well integrated, particularly with respect to billings of customers;

(5) that WorldCom's internal audit function did not examine or review financial data; and

(6) that efforts were not made to assure that all necessary adjustments were made so as to correctly and fairly present WorldCom's

quarterly financial position and results of operations.

433. Many of the factors that AU316 indicates may increase the risk of fraudulent financial reporting were present at WorldCom throughout the Class Period. Such red flags, which Andersen either intentionally ignored or recklessly disregarded, included:

(a) A failure of WorldCom's management to display and communicate an appropriate attitude regarding internal control and the financial reporting process, including management's setting unduly aggressive financial targets and expectations for operating personnel, exhibiting a disregard for internal auditing (e.g., precluding WorldCom's internal auditors from reviewing financial results), and failing to implement significant controls on such items as top-side adjustments (which were changed without any documentation or support);

(b) The overwhelming motivation for management to engage in fraudulent financial reporting, which included the personal motive that Ebbers had to maintain a high stock price (which stock he used as collateral for hundreds of millions of dollars of loans), the Company's need to maintain its "investment grade" credit rating in order to sell the $5 billion and $11.8 billion Note Offerings in 2000 and 2001, and the Company's need to maintain its stock price in order to continue its growth by acquisition strategy;

(c) Risk factors in the industry, in which there was a high degree of competition and market saturation, accompanied by declining margins, and increasing business failures, which also made WorldCom's own receivables far less likely to be paid; and

(d) Risk factors relating to operating characteristics and financial stability, including the inability to generate sufficient cash flows from operations while reporting earnings and earning growth; significant pressure to obtain additional capital necessary to

finance the Company's operations and capital expenditures; assets, liabilities, revenues and expenses based on significant estimates that involved unusually subjective judgment and uncertainties, such as the ultimate collectability of receivables, timing of revenue recognition, or significant deferral of costs; unusually rapid growth and reported profitability, especially compared with that of other companies in the same industry; unusually high dependence on debt, combined with debt covenants that were difficult to maintain; unrealistically aggressive sales or profitability incentive programs; and adverse consequences on significant pending transactions (such as the Note Offerings and acquisitions), if poor financial results were reported.

434. The Andersen Defendants knew or should have known that the above-identified fraud risk factors were present at WorldCom at the time its audits were performed during the Class Period. As a consequence, and taken collectively, the Andersen Defendants also knew that these risk factors present at WorldCom meant that the risk of fraudulent financial reporting was high. These Defendants, however, chose to turn a blind eye to the collective list of red flags, including direct knowledge from Brabbs' memos, and either intentionally ignored or recklessly disregarded its duty under AU316 to properly consider the above-identified risk factors.

435. WorldCom was the single most valuable client of Andersen's Jackson, Mississippi office. According to WorldCom's April 22, 2002 Proxy Statement, Andersen was paid a total of $16.8 million for its services to WorldCom during 2001. It received $4.4 million for services rendered "for the audit and quarterly reviews of WorldCom's financial statements;" $7.6 million for tax services; $1.6 million for "non-financial statement audit services;" and $3.2 million for "all other services."

436. As a result of the dissemination of the materially false and misleading information

and failure to disclose material facts, as set forth above, WorldCom stock and debt securities were sold in the public market, and the market prices of such securities were artificially inflated during the Class Period. In ignorance of the materially false and misleading nature of the reports and statements described above, plaintiffs relied to their detriment on the statements described above and/or on the integrity of the market prices as reflecting the completeness and accuracy of the information disseminated in connection with their purchases of the securities.

437. At the time of said misrepresentations and omissions, plaintiffs were ignorant of their falsity, and believed them to be true. Plaintiffs could not, in the exercise of reasonable diligence, have known the actual facts. Had plaintiffs known the truth, they would not have taken such action.

438. The markets for WorldCom securities were open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose the full truth about WorldCom and its financial condition, performance, and business, the securities traded at artificially inflated prices during the Class Period, reaching a high closing price of approximately $61 per share for the stock and $109.25 for the Notes, until the time the adverse information referred to above was finally provided to and digested by the securities markets. Plaintiffs purchased or otherwise acquired the securities relying upon the integrity of the market prices and market information relating to WorldCom, or in the alternative, upon defendants' false and misleading statements, and in ignorance of the adverse, undisclosed information known to defendants, and have been damaged thereby.

439. The prices of WorldCom securities declined materially upon the various partial public disclosures of the true facts about the fraudulent and improper practices which had inflated their prices and which material facts had been misrepresented and/or concealed as alleged herein.

Plaintiffs have suffered substantial damages as a result of their purchases of the securities.

440. By virtue of the foregoing, the above-identified defendants have violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT IX

(Against Defendants Salomon and Grubman for Violations of Section 10(b) of the Exchange Act and Rule 10b-5 (Registration Statements))

441. Plaintiffs repeat and reallege each and every allegation above, as if fully set forth herein.

442. This Count is brought on behalf of all Class members, and is based on WorldCom's SEC filings, including the registration statements for the 2000 Offering and the 2001 Offering, for which Salomon served as a lead underwriter.

443. Salomon and Grubman, in concert with others, individually and in concert, directly and indirectly, by the use of means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct that operated as a fraud and deceit upon plaintiffs; made various untrue and/or misleading statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; made the above statements with a severely reckless disregard for the truth; and employed devices, and artifices to defraud in connection with the purchase and sale of securities, which were intended to, and did: (i) deceive the investing public, including plaintiffs, regarding, among other things, WorldCom's financial statements and business prospects; (ii) artificially inflate and maintain the market price of WorldCom stock and debt securities; and (iii) cause plaintiffs to purchase WorldCom stock and debt securities at artificially inflated prices.

444. Salomon and Grubman, as more fully described above in ¶¶ 221-254, entered into

numerous, conflicting relationships that had the effect of forming a conspiracy between and among WorldCom, Ebbers, Sullivan, Salomon and Grubman. Pursuant to the plan and course of conduct, Salomon and Grubman participated, directly and indirectly, in the preparation and/or issuance of the statements and documents referred to above, including in WorldCom filings with the SEC, press releases, and registration statements. These statements and documents were materially false and misleading in that, among other things, they misrepresented, and failed to disclose, WorldCom's true financial condition, operation, results and business prospects during the Class Period.

445. At all relevant times, the material misrepresentations and omissions particularized herein directly or proximately caused the damages sustained by plaintiffs.

446. Salomon and Grubman, among others, engaged in such a scheme to misrepresent the financial condition and results of WorldCom and to consummate the acquisitions and Note Offerings, and maintain and/or inflate the prices of WorldCom's stock and debt securities, to obtain extremely lucrative work from WorldCom. As more fully described above, WorldCom retained Salomon for extremely lucrative investment banking and brokerage services, including: (a) WorldCom's retention of Salomon as a Lead Underwriter and/or Book Manager for each of the Note Offerings during the Class Period; (b) WorldCom's retention of Salomon as its "financial advisor" on the major acquisitions made or sought to be made by WorldCom; (c) WorldCom's retention of Salomon to manage its corporate stock option plans for WorldCom employees; and (d) WorldCom's designating Salomon as the broker for WorldCom employees' stock transactions.

447. For its part, Salomon and Grubman made sure that: (a) defendants Ebbers, Sullivan and Kellett were allocated Hot IPO shares that allowed Ebbers and the others to reap substantial profits from those IPOs; (b) Salomon's primary telecommunications analyst, defendant Grubman,

issued glowing reports during the Class Period concerning WorldCom, which reports continued until April 2002, when Grubman was forced by market conditions to finally lower his rating of WorldCom; (c) sending Grubman to attend meetings of WorldCom's Board and a subcommittee meeting called to discuss WorldCom's merger with MCI, and its later attempt to merge with Sprint; (d) providing "fairness opinions" and underwriting services to facilitate the many acquisitions made by WorldCom using its inflated stock, and the massive debt offerings - totaling approximately $23 billion from 1997 to May 2001 - undertaken by WorldCom; and (e) compensating Grubman based on the investment banking work that Grubman helped Salomon obtain from WorldCom through the issuance of his bullish, and materially misleading, analyst reports. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, WorldCom stock and debt securities were sold in the public market, and the market prices of such securities were artificially inflated during the Class Period. In ignorance of the materially false and misleading nature of the reports and statements described above, plaintiffs relied to their detriment on the statements described above and/or on the integrity of the market prices as reflecting the completeness and accuracy of the information disseminated by the Company in connection with their purchases of the securities.

448. At the time of said misrepresentations and omissions, plaintiffs were ignorant of their falsity, and believed them to be true. Plaintiffs could not, in the exercise of reasonable diligence, have known the actual facts. Had plaintiffs known the truth, they would not have purchased said securities.

449. The markets for WorldCom securities were open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose the full truth about WorldCom and its financial condition, performance, and business, the

securities traded at artificially inflated prices during the Class Period, reaching a high closing price of approximately $61 per share for the stock and $109.25 for the Notes, until the time the adverse information referred to above was finally provided to and digested by the securities markets. Plaintiffs purchased or otherwise acquired the securities relying upon the integrity of the market prices and market information relating to WorldCom, or in the alternative, upon defendants' false and misleading statements, and in ignorance of the adverse, undisclosed information known to defendants, and have been damaged thereby.

450. The prices of WorldCom securities declined materially upon the various partial public disclosures of the true facts about the fraudulent and improper practices which had inflated their prices and which material facts had been misrepresented and/or concealed as alleged herein. Plaintiffs have suffered substantial damages as a result of their purchases of the securities.

451. By virtue of the foregoing, Salomon and Grubman violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT X

(Against Defendant Salomon and Grubman for Violations of Section 10(b) of the Exchange Act and Rule 10b-5 (Analyst Reports))

452. Plaintiffs repeat and reallege each and every allegation contained above, as if fully set forth herein.

453. This Count is brought on behalf of all Class members, and is based on the analyst reports that defendants Salomon and Grubman issued during the Class Period.

454. Salomon and Grubman, in concert with others, individually and in concert, directly and indirectly, by the use of means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct that operated as a fraud and deceit upon plaintiffs; made various untrue and/or misleading statements of material facts and omitted to state

material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; made the above statements with a severely reckless disregard for the truth; and employed devices, and artifices to defraud in connection with the purchase and sale of securities, which were intended to, and did: (i) deceive the investing public, including plaintiffs, regarding, among other things, WorldCom's financial statements and business prospects; (ii) artificially inflate and maintain the market price of WorldCom stock and debt securities; and (iii) cause plaintiffs to purchase WorldCom stock and debt securities at artificially inflated prices. Pursuant to the plan and course of conduct described herein, Salomon and Grubman participated, directly and indirectly, in the preparation and/or issuance of the statements and documents referred to above, i.e., the analyst reports issued by Salomon and Grubman during the Class Period. These statements and documents were materially false and misleading in that, among other things, they misrepresented, and failed to disclose, Salomon's conflicted position with respect to WorldCom, as described in ¶¶ 256-274.

455. At all relevant times, the material misrepresentations and omissions particularized herein directly or proximately caused the damages sustained by plaintiffs.

456. Salomon and Grubman engaged in the foregoing scheme to misrepresent WorldCom's true status and to consummate the acquisitions and Note Offerings, and maintain and/or inflate the prices of WorldCom's stock and debt securities, to obtain extremely lucrative work from WorldCom. As more fully described above, WorldCom retained Salomon for extremely lucrative investment banking and brokerage services, including: (a) WorldCom's retention of Salomon as a Lead Underwriter and/or Book Manager for each of the Note Offerings during the Class Period; (b) WorldCom's retention of Salomon as its "financial advisor" on the major acquisitions made or sought to be made by WorldCom; (c) WorldCom's retention of Salomon to

manage its corporate stock option plans for WorldCom employees; and (d) WorldCom's designating Salomon as the broker for WorldCom employees' stock transactions.

457. For its part, Salomon and Grubman made sure that: (a) defendant Ebbers, Sullivan and Kellett were allocated Hot IPO shares, that allowed Ebbers and the others to reap substantial profits from those IPOs; (b) Salomon's primary telecommunications analyst, defendant Grubman, issued glowing reports concerning WorldCom during the Class Period, when Grubman was forced by market conditions to finally lower his rating of WorldCom; (c) sending Grubman to attend meetings of WorldCom's Board and a subcommittee meeting called to discuss WorldCom's merger with MCI, and its later attempt to merge with Sprint; (d) providing "fairness opinions" and underwriting services to facilitate the many acquisitions made by WorldCom using its inflated stock, and the massive debt offerings - totaling approximately $23 billion from 1997 to May 2001 - undertaken by WorldCom; and (e) compensating Grubman based on the investment banking work that Grubman helped Salomon obtain from WorldCom through the issuance of his bullish, and materially misleading, analyst reports. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, WorldCom stock and debt securities were sold in the public market, and the market prices of such securities were artificially inflated during the Class Period. In ignorance of the materially false and misleading nature of the reports and statements described above, plaintiffs relied to their detriment on the statements described above and/or on the integrity of the market prices as reflecting the completeness and accuracy of the information disseminated in the analyst reports issued by Salomon and Grubman in connection with their purchases of the securities.

458. At the time of said misrepresentations and omissions, plaintiffs were ignorant of their falsity, and believed them to be true. Plaintiffs could not, in the exercise of reasonable

diligence, have known the actual facts. Had plaintiffs known the truth, they would not have taken such action.

459. The markets for WorldCom securities were open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose the full truth about WorldCom and its financial condition, performance, and business, the securities traded at artificially inflated prices during the Class Period, reaching a high closing price of approximately $61 per share for the stock and $109.25 for the Notes, until the time the adverse information referred to above was finally provided to and digested by the securities markets. Plaintiffs purchased or otherwise acquired the securities relying upon the integrity of the market prices and market information relating to WorldCom, or in the alternative, upon defendants' false and misleading statements, and in ignorance of the adverse, undisclosed information known to defendants, and have been damaged thereby.

460. The prices of WorldCom securities declined materially upon the various partial public disclosures of the true facts about the fraudulent and improper practices which had inflated their prices, including the analyst reports, and which material facts had been misrepresented and/or concealed as alleged herein. Plaintiffs have suffered substantial damages as a result of their purchases of the securities.

461. By virtue of the foregoing, Salomon and Grubman violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT XI

(Against Defendants Citigroup and Salomon for Violations of Sections 20(a) of the Exchange Act)

462. This Count is asserted on behalf of all Class members. Plaintiffs repeat and reallege each and every allegation contained above, as if fully set forth herein.

463. Plaintiffs assert this Count for violations of Section 20(a) of the Exchange Act against Citigroup and Salomon.

464. Through their positions of control and authority as (a) the 100% owner of Salomon, and (b) Grubman's employer, defendant Citigroup was able to and did control, directly and indirectly, the content of the public statements disseminated by Salomon and Grubman, and Salomon was able to and did control, directly and indirectly, the context of analyst reports issued by Grubman. With knowledge of the falsity of the statements contained therein or in severely reckless disregard of the truth about the analyst reports issued by Grubman, Citigroup and Salomon caused the false and misleading statements and omissions of material facts as alleged herein.

465. Citigroup is the controlling corporate parent of Salomon, and Salomon was Grubman's direct employer. As such, the defendants are presumed to have had the power to control or influence the particular transactions giving rise to the securities violations alleged herein, and exercised the same.

466. By reason of their ownership, management and direct supervising positions with respect to Grubman, Citigroup and Salomon were "controlling persons" within the meaning of Section 20(a) of the Exchange Act. Citigroup had the power and influence to direct the management and activities of Salomon, Grubman and other Salomon managers, directors and employees, and to cause them to engage in the unlawful conduct complained of herein. Salomon had the power and influence to direct the activities of Grubman, and to cause him to engage in the unlawful conduct complained of herein.

467. Because of their positions, Citigroup and Salomon had access to adverse non-public financial information about the relationship between and among WorldCom, Ebbers, Sullivan, Salomon and Grubman, as well as the falsity of the analyst reports issued by Salomon and

Grubman, and acted to conceal the same, or knowingly or recklessly authorized and approved the concealment of the same.

468. By virtue of the foregoing, these defendants have violated Section 20(a) of the Exchange Act.

469. Plaintiffs have been damaged by the violations of these defendants as described in this Count and seek recovery of damages caused thereby.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray for judgment as follows;

A. Certifying this action as a Class Action on behalf of the Class pled in this Complaint;

B. Awarding plaintiffs compensatory damages, together with appropriate prejudgment interest at the maximum rate allowable by law;

C. Awarding plaintiffs their costs and expenses for this litigation, including reasonable attorneys' fees, expert fees and other disbursements; and

D. Awarding plaintiffs such other and further relief as may be deemed just and proper under the circumstances.

JURY DEMAND

Pursuant to Rule 38 of the Federal Rules of Civil Procedure, plaintiffs hereby demand a trial by jury as to all issues so triable.

DATED: New York, New York
October 11, 2002

BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP

_/s/ John P. Coffey______________
Max W. Berger (MB-5010)
John P. Coffey (JC-3832)
Steven B. Singer (SS-5212)
Beata Gocyk-Farber (BGF-5420)
Jennifer L. Edlind (JE-9138)
Joseph A. Fonti (JF-3201)
1285 Avenue of the Americas
New York, New York 10019
(212) 554-1400

-and-

BARRACK, RODOS & BACINE

_/s/ Jeffrey W. Golan___________
Leonard Barrack
Gerald J. Rodos
Jeffrey W. Golan
Jeffrey A. Barrack
Pearlette V. Toussant
3300 Two Commerce Square
2001 Market Street
Philadelphia, Pennsylvania 19103
(215) 963-0600

Attorneys for Lead Plaintiff H. Carl McCall, Comptroller of the State of New York, as Administrative Head of New York State and Local Retirement Systems and as Trustee of the New York State Common Retirement Fund, and Co-Lead Counsel for the Class

Named Plaintiffs' Counsel:

BERMAN DeVALERIO PEASE TABACCO
BURT & PUCILLO
Joseph J. Tabacco, Jr. (JT-1994)
425 California Street, Suite 2025
(415) 433-3200
- and -
Michael J. Pucillo
515 North Flagler Drive, Suite 1701
West Palm Beach, FL 33401
(561) 835-9400

Attorneys for Additional Named Plaintiffs The Fresno County Employees Retirement Association and the County of Fresno, California

SCHOENGOLD & SPORN, P.C.
Christopher Lometti (CL-9124)
19 Fulton Street, Suite 406
New York, NY 10038
(212) 661-1100

Attorneys for Additional Named Plaintiffs HGK Asset Management, Inc.

Additional Plaintiffs' Counsel:

Stanley M. Grossman
POMERANTZ HAUDEK BLOCK
GROSSMAN & GROSS LLP
100 Park Avenue, 26th Floor
New York, NY 10017
(212) 661-1100

Steven J. Toll
COHEN, MILSTEIN, HAUSFELD & TOLL
1100 New York Avenue, N.W.
West Tower, Suite 500
Washington, D.C. 20005
(202) 408-4600

Ann D. White
Jayne A. Goldstein
MAGER WHITE & GOLDSTEIN, LLP
One Piticairn Place, Suite 2400
165 Township Line Road
Jenkintown, PA 19046
(215) 481-0273

Robert I. Harwood
WECHSLER HARWOOD LLP
488 Madison Avenue, 8th Floor
New York, NY 10022
(212) 935-7400

Garrett D. Blanchfield, Jr.
Mark Reinhardt
REINHARDT & ANDERSON
E-1000 First National Bank Building
332 Minnesota Street
Saint Paul, MN 55101
(651) 227-9990

Jacqueline Sailer
Brian Philip Murray
Eric J. Belfi
RABIN & PECKEL, LLP
275 Madison Avenue
New York, NY 10016
(212) 682-1818

Klari Neuwelt
LAW OFFICE OF KLARI NEUWELT
110 East 59th Street, 29th Floor
New York, NY 10022
(212) 593-8800

Jules Brody
Aaron Lee Brody
Tzivia Brody
STULL, STULL & BRODY
6 East 45th Street
New York, NY 10017
(212) 687-7230

Joseph H. Weiss
WEISS & YOURMAN
551 Fifth Avenue, Suite 1600
New York, NY 10176
(212) 682-3025

Ira M. Press
KIRBY, MCINERNEY & SQUIRE, LLP
830 Third Avenue
New York, NY 10022
(212) 371-6600

Lionel Z. Glancy
GLANCY & BINKOW, LLP
1801 Avenue of the Stars, Suite 311
Los Angeles, CA 90067
(310) 201-9150

James H. Haddad
PIRK & HADDAD, LLP
36 Nimitz Street
Huntington, NY 11743
(212) 982-8326

Gregory Michael Egleston
Mel E. Lifshitz
BERNSTEIN LIEBHARD & LIFSHITZ, LLP
10 East 40th Street
New York, NY 10016
(212) 779-1414

Marc A. Topaz
SCHIFFRIN & BARROWAY, LLP
Three Bala Plaza East, Suite 400
Bala Cynwyd, PA 19004
(610) 667-7706

Paul J. Geller
CAULEY, GELLER, BOWMAN
& COATES, LLP
One Boca Place
2255 Glades Road, Suite 421A
Boca Raton, FL 33431
(561) 750-3000

Brian M. Felgoise
LAW OFFICE OF BRIAN M. FELGOISE
230 South Broad Street, Suite #404
Philadelphia, PA 19102
(215) 735-6810

Evan J. Smith
BRODSKY & SMITH, LLC
11 Bala Avenue, Suite #39
Bala Cynwyd, PA 19004
(610) 668-7987

Marc S. Henzel
LAW OFFICES OF MARC S. HENZEL
273 Montgomery Avenue, Suite 202
Bala Cynwyd, PA 19004
(610) 660-8000

Victor E. Stewart
Christopher Lovell
Christopher J. Gray
LOVELL STEWART HALEBIAN, LLP
500 Fifth Avenue
New York, NY 10110
(212) 608-1900

Theodore T. Mairanz
NEIMAN, GINSBURG & MAIRNAZ
39 Broadway, 25th Floor
New York, NY 10006
(212) 269-1000

Mark C. Gardy
ABBEY GARDY, LLP
212 East 39th Street
New York, NY 10016
(212) 889-3700

Samuel Rosenberg
LAW OFFICES OF JACOBS ROSENBERG
One Gateway Center
Newark, NJ 07102
(973) 621-8000

David B. Kahn
Mark E. King
DAVID B. KAHN & ASSOCIATES, LTD.
One Northfield Plaza, Suite 100
Northfield, IL 60093
(847) 501-5083

Louis F. Burke
LOUIS F. BURKE, PC
360 Lexington Avenue, 14th Floor
New York, NY 10017
(212) 682-1700

Peter D. Bull
Joshua M. Lifshitz
BULL & LIFSHITZ, LLP
18 East 41st Street, 11th Floor
New York, NY 10017
(212) 213-6222

A. Arnold Gershon
BALLON, STOLL, BADER & NADLER, PC
1450 Broadway, 14th Floor
New York, NY 10018-2268
(212) 575-7900

Charles J. Piven
LAW OFFICES OF CHARLES J. PIVEN
The World Trade Center-Baltimore
401 East Pratt Street, Suite 2525
Baltimore, MD 21202
(410) 332-0030

Federico Vazquez
3 Argosy Circle
Gaithersburg, MD 20878
(301) 670-9812

David Jaroslawicz
JAROSLAWICZ & JAROS
150 William Street
New York, NY 10038
(212) 227-2780

Deborah R. Gross
LAW OFFICES OF
BERNARD M. GROSS, P.C.
1515 Locust Street
Philadelphia, PA 19102
(215) 561-3600

Trig R. Smith
DYER & SHUMAN, LLP
801 East 17th Avenue
Denver, CO 80218
(303) 861-3003