

OCT 15 2003

Michael N. Milby, Clerk of Court
U.S. DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON, TEXAS

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE ENRON CORPORATION) No. H-01-3624
SECURITIES LITIGATION)
) Hon. Melinda Harmon

**DEFENDANT AWSC SOCIÉTÉ COOPÉRATIVE, EN LIQUIDATION'S
MEMORANDUM IN RESPONSE TO OBJECTIONS OF CERTAIN
CLASS MEMBERS TO PROPOSED PARTIAL SETTLEMENT**

Defendant AWSC Société Coopérative, en liquidation ("AWSC (*l*)"), by its attorneys, respectfully submits this memorandum in response to the objections of certain class members to the proposed partial settlement between plaintiffs and AWSC (*l*).

INTRODUCTION

At the outset, it is important to note that there are very few objections to the proposed settlement at all. Of those few objections that have been filed, most are based on one or both of the following mistaken premises:

- (1) that the settlement provides that the portion of the settlement that is not being set aside to pay expenses will be paid to plaintiffs' counsel; and
- (2) that Arthur Andersen LLP ("Andersen LLP") (the firm that signed the audit opinions on Enron's financial statements) and its partners are being released by the settlement.

Neither premise is true. First, the settlement agreement explicitly provides that if plaintiffs' counsel seek any payment of fees from the fund, that will require further notice to the class and court approval. Second, the agreement explicitly excludes Andersen LLP and its partners from the scope of the release.¹

¹ AWSC (*l*) understands that the representative plaintiffs intend to file a memorandum in support of the motion for final approval of the partial settlement. AWSC (*l*) will not repeat the arguments made in that memorandum.

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That leaves only the objections of James H. Allen, Jr., Burton W. Carlson, Jr., Michael De Freece, Marcia A. De Freece, Andrew E. Krinock, Phyllis A. Krinock, Partcom Limited Partnership, Reed Partners, L.P., formerly known as Reed Family Ltd. Partnership, F. Walker Tucei, Jr., June P. Tucei, Roman Uhing, Alvera A. Uhing, and Viets Family Associates, LLP (the “Andersen LLP Objectors”). These objections were filed for an improper purpose. The Andersen LLP Objectors would like to scuttle the settlement in the hopes that the \$40 million settlement fund would be returned to AWSC (*I*), where they hope they could get a larger piece of it as retired Andersen LLP partners than they would as members of the settlement class.

The 13 Andersen LLP Objectors are retired partners or participating principals of Andersen LLP (or their spouses or limited partnerships of which they are general partners) who are in arbitration against Andersen LLP and who have sued other firms (which certain Andersen LLP partners joined in the last two years) for certain retirement benefits that they allege are owed by Andersen LLP. See Complaint, Viets v. Deloitte & Touche LLP, et al., No. 49D12-0211-CT-1926 (State of Indiana Mar. 17, 2003) (excerpt attached as Exhibit A.) They also have filed a claim against AWSC (*I*) in Switzerland, alleging that if Andersen LLP does not pay their benefits, AWSC (*I*) has an obligation to pay them. Most recently, counsel for these objectors threatened to interfere with this settlement between AWSC (*I*) and the Newby, WSIB, and Tittle classes if AWSC (*I*) would not capitulate to their demands. When AWSC (*I*) refused to be extorted, the Andersen LLP Objectors filed the instant objections. At bottom, the filing of these objections by the Andersen LLP Objectors is a gambit to destroy or delay the settlement so that the Andersen LLP Objectors can assert claims on the \$40 million at issue. Such a result plainly would not benefit the class.

In light of these facts, it should come as no surprise that there is no merit whatsoever to the assertions made by the Andersen LLP Objectors. The Andersen LLP Objectors misconstrue the terms of the settlement and misstate the role played by AWSC (*I*) in the Enron audits. AWSC (*I*) did no audit work on the Enron engagement (or any other engagement), and, as numerous other courts have held in almost identical cases – including this past summer in the Worldcom securities litigation – no claim could be stated against AWSC (*I*) for securities fraud. The unsupported allegation that this settlement is the product of some sort of wrongful “collusion” is reprehensible: the settlement was the outgrowth of negotiations conducted under the supervision of a court-appointed mediator; was reported promptly to the Court (and was the subject of great publicity) at the time the Memorandum of Understanding was signed; and already has received the preliminary approval of this court. These objections should be rejected for what they are – an improper effort to advance interests that are directly opposed to the interests of the class.

ARGUMENT

I. THE ANDERSEN LLP OBJECTORS’ INTERESTS ARE AT ODDS WITH THE INTERESTS OF THE CLASS.

The objections by the Andersen LLP Objectors should be rejected out of hand. The 13 objectors have filed these objections in a transparent attempt to undermine the partial settlement for reasons that are wholly unrelated to the circumstances of this case.

AWSC (*I*) first became aware of the possibility that these objectors would attempt to interfere with the partial settlement in August 2003. On August 18, 2003, AWSC (*I*) received a facsimile from Blair C. Fensterstock of Fensterstock & Partners LLP. (See Exhibit B.) In that letter, Mr. Fensterstock wrote that he represents “retired partners and participating principals of Arthur Andersen LLP” and listed those persons in an attachment to the letter. (Id. at 1.) Those

persons include James Allen, Dean Busching, Burton Carlson, Michael DeFreece, Andrew Krinock, John Reed, Walker Tucei, Roman Uhing, and Gilbert Viets. (Id. at Annex A.) These persons – either individually, through their spouses, or through limited partnerships – are the 13 objectors here. Thus, it is a group of former Andersen LLP partners and principals who are objecting to this settlement. On its face, such an objection presents an unacknowledged conflict: no retired partner who has a financial interest in a defendant should be allowed to object to a settlement that will benefit the class plaintiffs.

But the August 18th letter reveals a far more serious and immediate conflict. That letter states that these 13 objectors “believe that AWSC is obligated to make [Andersen LLP’s retirement] payments” and demands payment of over \$14 million to these objectors alone. (Id. at 1 & Annex A.) Mr. Fensterstock also represents 120 additional retired Andersen LLP partners who claim that AWSC (*I*) owes them an additional \$175 million. Of course, these retirement benefit claims have nothing whatsoever to do with Enron. These claims also dwarf any claims that the Andersen LLP Objectors have by virtue of their purchases of Enron securities. Even the largest purchasers of Enron shares among the Andersen LLP Objectors, Michael and Marcia DeFreece, purchased only \$54,600 in Enron shares – all at the rock bottom price of \$5.46 per share – less than a week before the end of the class period. (See Certifications of Michael T. DeFreece and Marcia A. DeFreece.) By contrast, the DeFreeces claim to be owed \$3 million in retirement benefits. (See August 18 Letter, Annex A.) A comparison of the purchases of Enron shares listed by the Andersen LLP Objectors with the claims relating to retirement benefits made in Mr. Fensterstock’s August 18 letter reveals a similar pattern:

Objector(s)	Amount Paid For Enron Shares	Claimed Retirement Benefits
James Allen	\$22,012	\$1,548,000

Burton Carlson	\$20,732	\$932,000
Michael & Marcia DeFreece	\$54,600	\$3,016,000
Andrew & Phyllis Krinock	\$1,985	\$1,225,000
Partcom Limited Partnership (Dean Busching, general partner)	\$36,624	\$485,000
Reed Partners, L.P. (John Reed, managing general partner)	\$50,950	\$1,252,000
Walker & June Tucei	\$18,821	\$2,422,000
Roman & Alvera Uhing	\$5,290	\$714,000
Viets Family Associates, LLP (Gilbert Viets, general partner)	\$17,660	\$3,095,000
TOTAL	\$228,676	\$14,689,000

Even if the Andersen LLP Objectors were to be made entirely whole for their purchases of Enron shares by virtue of the class settlement with AWSC (*I*) – a result that would be absurd on its face – that recovery would amount to less than two percent of the amounts of the demands these same individuals have made (and only a tenth of a percent of the amounts of the demands made by Mr. Fensterstock’s other clients) on AWSC (*I*) in connection with their purported retirement benefits. The pecuniary interest of these objectors (and their counsel) is clear. The Andersen LLP Objectors purport to be concerned with “whether the class is receiving adequate compensation for releasing their claims.” (Objections Memorandum at 1-2.) But this “concern” is disingenuous.

These objections are an attempt to gain leverage against AWSC (*I*) for purposes entirely unrelated to the welfare of the plaintiff class. Indeed, a follow-up letter from the Fensterstock firm confirms as much. On August 28, 2002, Maureen McGuirl of Fensterstock & Partners LLP – the very same attorney who signed the instant objections – attempted to extort payment of purported retirement benefits (or at least a tolling agreement for those claims) from AWSC (*I*):

Moreover, we are hereby putting AWSC on notice that we reserve the right to take any steps legally available to secure the recovery of the amounts claimed. This includes, but is not limited to, protective measures relating to the payment that AWSC may have made or may make under the recently reported settlement with the Enron plaintiffs.

(August 28, 2002, Letter (emphasis added), attached as Exhibit C.) The bad faith objections of the Andersen LLP Objectors simply should be ignored.²

II. THE SETTLEMENT IS FAIR AND REASONABLE.

Moreover, the objections by the Andersen LLP Objectors have no merit. The objections depend upon the false premises that AWSC (*I*) played some role in the audits of Enron entities, which it did not, and that the settlement releases persons and claims that it does not. The Andersen LLP Objectors rely exclusively on a single, conclusory paragraph repeated in the affidavits of two of them – Burton Carlson and Gilbert Viets:

I was a partner of Andersen Worldwide Société Coopérative (“AWSC”) during the period of its inception through August 31, 1994 [or June 30, 2000]. AWSC was the entity in charge of establishing and enforcing accounting and professional standards, as well as quality control techniques and procedures of, educating and training personnel of, and coordinating client services on a worldwide basis for, all of its member firms, including Arthur Andersen LLP and any other affiliated entities that may have provided professional services to Enron.

(Affidavits of Burton Carlson and Gilbert Viets, ¶ 6.) The conclusions expressed in these affidavits, however, are simply incorrect.

² It is notable that the Andersen LLP Objectors do not claim that the settlement is unfair or unreasonable and should not be approved. Instead, they seek delay. (See, e.g., Objections Memorandum at 2 (“At present, the Court lacks the information necessary ...”), 3 (urging “the Court to seek more information ...”), 5 (“the value of the settlement is unclear”), 5 n. 2 (“The Court also has an obligation to make such an inquiry before approving the proposed settlement.”), and 13 (“Before the Court grants final approval ...”). This tactic is perfectly consistent with the Andersen LLP Objectors’ desire to pursue their retirement claims first, only then to insist on their share of whatever remains for the Enron class.

As an initial matter, neither affiant claims to have personal knowledge about how the audits of Enron's financial statements were conducted. Indeed, one retired long before any of the events at issue in this litigation.

Moreover, the class complaint itself refutes the central proposition offered here – that AWSC (*l*) was “the entity primarily responsible for developing and enforcing accounting and professional standards for Arthur Andersen LLP and its worldwide affiliates.” (*Id.*; see also Objections Memorandum at 11.) As the complaint alleges, the Professional Services Group (“PSG”), composed of Andersen LLP personnel, was the group that advised audit engagement teams on complex issues of Generally Accepted Accounting Principles (“GAAP”) and Generally Accepted Auditing Standards (“GAAS”) (Cmplt. ¶ 913)³ Accordingly, the only persons in the Newby complaint who are alleged to have played a role in PSG with respect to the Enron audits were Andersen LLP partners – who have not been released. (*Id.* ¶¶ 93(1), (m).) Moreover, it was Andersen LLP – and not AWSC (*l*) – that was engaged to perform the audits and that signed the audit opinion letters that form the basis for the complaints at issue. (*Id.* ¶ 903.) By contrast, AWSC (*l*) was prohibited by its organizational documents from performing audit work or earning a profit. See Nasser v. Andersen Worldwide Societe Cooperative, 2003 WL 22179008, at *4 (S.D.N.Y. Sept. 23, 2003) (attached as Exhibit D).

Numerous courts that have taken a close look at the relationship between AWSC (*l*) and the professional services firms that have cooperated in the market under the name “Andersen” have rejected claims similar to those advanced by the Andersen LLP Objectors. As early as 1985, one district judge explicitly held that “plaintiffs are incorrect in characterizing

³ The GAAP and GAAS that governed the presentation and audits of Enron's financial statements are United States standards.

Andersen as a ‘single worldwide partnership.’” In re DeLorean Motor Co. Litig., No. 83-CV-2137-DT, slip op. at 8 (E.D. Mich. Nov. 19, 1985) (attached as Exhibit E). That holding was confirmed in 1998, when in Andersen Consulting Bus. Unit Member Firms v. Andersen Worldwide Societe Cooperative, 1998 WL 122590 (S.D.N.Y. Mar. 16, 1998) (attached as Exhibit F), another district judge explained that in the various countries there existed separate “Andersen member firm[s],” each of which “is an independent legal entity.” Id. at *1. The court further explained that in contrast to these member firms, which provided “tax and audit services” and also “consulting services,” AWSC (*l*) was an “administrative organization.” Id. This description is utterly inconsistent with the Andersen LLP Objectors’ conclusory description of AWSC’s role.

Most recently, in Nasser v. Andersen Worldwide Societe Cooperative, yet another district judge in New York made findings that belie the conclusory statements offered by the Andersen LLP Objectors here. (See Exhibit D.) The court found that:

- “[e]ach national practice was to be kept separate and autonomous” (2003 WL 22179008 at *1 n. 1);
- “to the extent plaintiffs rely on assertions that other ‘Andersen’ entities, i.e., Andersen member firms, may be linked to AWSC to establish AWSC's domestic presence for subject matter jurisdiction purposes, these assertions are refuted by the evidentiary materials presented” (id. at *4);
- “AWSC was created to coordinate administratively the separate and autonomous national practice entities affiliated with Arthur Andersen & Co.” (id.); and
- AWSC “does not engage in professional practice, nor does it earn net income” (id.).

In light of these facts, the objections asserted here ring hollow.

It is for these reasons that the claims of the plaintiff class against AWSC and the non-United States defendant member firms are extraordinarily weak – and that the settlement is

plainly fair for the plaintiff class. An almost identical securities fraud class action against AWSC (*I*) relating to Worldcom recently was dismissed with prejudice. See In re Worldcom, Inc. Sec. Litig., 2003 WL 21488087 (S.D.N.Y. June 25, 2003) (attached as Exhibit G). As in Worldcom, the instant complaint “contains no allegations that AWSC was the source of or an identified speaker with respect to any of the misrepresentations described in the Complaint, and contains no allegations of AWSC’s scienter.” Id. at *9. The Worldcom court held that a claim for derivative liability against AWSC (*I*) could not be stated under a theory of global partnership or agency, and dismissed the case against AWSC (*I*) with prejudice, denying leave to amend (and discouraging motions to do so) because of “the numerous legal barriers to pleading a Section 10(b) claim against any of the dismissed defendants.” Id. at *10 & *11 n. 10.

The Worldcom decision is only the latest in a series of cases⁴ in which courts have rejected similar claims of derivative liability against international coordinating entities or

⁴ See, e.g., In re Lernout & Hauspie Sec. Litig., 230 F. Supp. 2d 152, 172-73 (D. Mass. 2002) (allegations of the “‘co-extensive responsibility’ and collaboration” between KPMG member firms in conducting audits “all under the umbrella name of KPMG” could not demonstrate that KPMG Belgium’s conduct “occurred at the behest of, on behalf of, under the direction of, or subject to the control of KPMG International”); Bamberg v. SG Cowen, 236 F. Supp. 2d 79 (D. Mass. 2002) (same); In re A.M. Int’l, Inc. Sec. Litig., 606 F. Supp. 600, 607 (S.D.N.Y. 1985) (dismissing allegations against “various foreign affiliates of Price Waterhouse on the theory that all the Price Waterhouse firms world-wide are in fact one entity, and acted as agents of one another”); Cromer Fin. Ltd. v. Berger, 137 F. Supp. 2d 452, 485 & n. 23 (S.D.N.Y. 2001) (dismissing Section 10(b) claims against Ernst & Young International despite allegations that “Ernst & Young operated as a global, financially interdependent enterprise and that EYI provided executive management and strategic direction for its members,” because “there was no reference to EYI in the documents in which the false statements were contained”); Jeffries v. Deloitte Touche Tohmatsu Int’l, 893 F. Supp. 455, 457 (E.D. Pa. 1995) (granting summary judgment for DTTI, “a Swiss Verein that provides coordination services among its member firms, one of which is Deloitte & Touche”); Howard v. Klynveld Peat Marwick Goerdeler, 977 F. Supp. 654, 662 (S.D.N.Y. 1997) (dismissing allegations of “public relations materials suggest[ing that KPMG] is a global firm or an international network of member firms” because they do not support “a legal finding of partnership”); Reingold v. Deloitte Haskins & Sells, 599 F. Supp. 1241, 1254 n.10 (S.D.N.Y. 1984) (references in “brochures and pamphlets describing DH&S (U.S.) in terms such as ‘a single cohesive worldwide organization’” insufficient to

networks of accounting firms on the merits or on jurisdictional theories. Indeed, AWSC (*I*) is unaware of any case in which the international coordinating entity of a network of professional firms has been found liable under a global partnership theory. Given this authority, there can be little question that a \$40 million settlement is fair and reasonable.⁵ Moreover, given substantial questions that have been raised concerning the Court's jurisdiction over AWSC (*I*), the plaintiffs would likely encounter significant difficulties in enforcing and collecting any judgment against AWSC (*I*).

Although the settlement releases AWSC (*I*) and other foreign entities, it does not release Andersen LLP or its partners. This is a basic element of the settlement, but it appears that the Andersen LLP Objectors have ignored it. The fairness objections rely almost exclusively on the notion that the "complaint alleges that Arthur Andersen LLP and the other AWSC entities failed to conform to the standards of care applicable to accountants and auditors." (Objections Memorandum at 11-12.) The Andersen LLP Objectors do not distinguish between the substantial role that Andersen LLP is alleged to have played in performing the year-end audits of Enron's financial statements in the United States and the extremely limited role alleged to have been played by the professional services firms outside the United States. (Compare Cmplt. ¶¶ 897-970, with Cmplt. ¶ 897.) Taken with the misunderstanding of the role played by

establish a global partnership); Goh v. Baldor Elec. Co., No. 3:98-MC-064-T, 1999 WL 20943, at *3 (N.D. Tex. Jan. 13, 1999) (denying motion to compel domestic Ernst & Young to produce documents controlled by foreign Ernst & Young firm); In re Citric Acid Litig., 191 F.3d 1090, 1108 (9th Cir. 1999) (affirming denial of motion to compel Coopers & Lybrand L.L.P. to produce documents controlled by Societe Fiduciare Suisse Coopers & Lybrand).

⁵ This is especially true in light of the proportionate liability provision of the Private Securities Litigation Reform Act of 1995. See 15 U.S.C. § 78u-4(f)(2)(B)(i).

AWSC (*I*), as discussed above, it appears that much of the substance of the objections at issue is based upon a misguided sense of who will be released by the settlement and who will not.⁶

III. THE SETTLEMENT IS NOT THE PRODUCT OF FRAUD OR COLLUSION.

The Andersen LLP Objectors ultimately retreat to the desperate – and unsupported – speculation that the settlement “may be the product of collusion and fraud.” (Objections Memorandum at 13.) The sole basis for this irresponsible claim is the fact that approval of the partial settlement was not sought until July 2003. But the Andersen LLP Objectors ignore the fact that the key feature of the settlement, \$40 million to be paid to the class, was reached in August 2002 – and that feature has not changed. As the Court knows, this settlement was reached as an outgrowth of the efforts of Eric Green, a court appointed mediator who attempted to achieve an agreement between the plaintiffs and Arthur Andersen LLP. When that proved impossible, this partial settlement was reached while AWSC (*I*)’s motion to dismiss was still pending. The settlement was documented in a preliminary Memorandum of Understanding in August 2002, was promptly reported to the Court, and was the subject of widespread publicity at that time. AWSC paid \$40 million into escrow then as well. No basis exists to suggest that this settlement is fraudulent or “collusive.”

Finally, the Andersen LLP Objectors suggest that the liquidation of AWSC (*I*) should be considered by this Court. AWSC (*I*) agrees. AWSC (*I*) has very limited resources, a

⁶ The Andersen LLP Objectors also complain that more discovery should be conducted on “successor,” “acquirer,” or “merger” firms. This complaint is no surprise; the Andersen LLP Objectors themselves have filed suit against such firms in an effort to obtain the very retirement benefits about which they really care. (See Exhibit A.) The complaint in this case does not mention any such firms, and the Andersen LLP Objectors have given no basis for how such firms could be liable for anything. Moreover, the release by its terms does not apply to Andersen LLP, its partners, or their successors, only to the successors of the Released Entities. See Stipulation of Partial Settlement ¶¶ 1.5 (definition of “AWSC Entity”), 1.30 (definition of “Released Claims”), and 1.31 (definition of “Released Entities”).

fact that strongly supports the approval and prompt implementation of this settlement for anyone interested in the class receiving the proceeds of this settlement.⁷ Of course, as discussed above, the Andersen LLP Objectors have no interest in that outcome.

⁷ If the settlement is not approved, then under the Stipulation of Settlement the \$40 million settlement fund must be returned to AWSC(*l*), with interest, less only certain costs of administration.

CONCLUSION

For the foregoing reasons, AWSC Société Coopérative, en liquidation respectfully requests that this Court reject the objections of the Andersen LLP Objectors and grant final approval to the partial settlement.

Respectfully submitted,

William E. Matthews

One of the Attorneys for Defendant *by permission*
AWSC Société Coopérative, en liquidation *ACD*

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TX Bar No. 24026801*

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Counsel for Defendant
AWSC Société Coopérative, en liquidation

Dated: October 16, 2002

STATE OF INDIANA)
) SS:
COUNTY OF MARION)

IN THE MARION SUPERIOR COURT
CAUSE NO. 49D12-0211-CT-001926

GILBERT F. VIETS, and All Others)
Similarly Situated,)

Plaintiffs,)

v.)

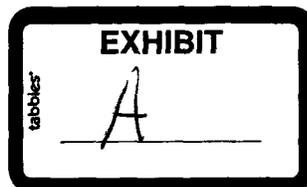
DELOITTE & TOUCHE LLP; ERNST)
& YOUNG LLP; KPMG LLP;)
PRICEWATERHOUSECOOPERS LLP;)
GRANT THORNTON LLP;)
BEARINGPOINT, INC. (formerly known)
as KPMG CONSULTING, INC.); and)
SUSAN ALEXANDER; JEFFREY BERGERON;)
DERRICK BURKS; SEAN DALY; DEBORAH)
DEHAAS; JEFFREY DOBBS; THOMAS ERTEL;)
BRADLEY GABOSCH; MARION GAJEK;)
TIMOTHY HANLEY; PAUL KEGLEVIC;)
MICHAEL MCGUIRE; SCOTT OZANUS;)
ROBERT SOZA; GAIL STEINEL; and RONALD)
WEISSMAN, and All Others Similarly Situated;)
and LARRY GORRELL; TERRY)
HATCHETT; JOHN NIEMANN, JR.; STEPHEN)
ROGERS; and LOUIS SALVATORE,)

Defendants.)

SECOND AMENDED CLASS ACTION COMPLAINT

DEMAND FOR JURY TRIAL

Plaintiff Gilbert F. Viets, on behalf of himself and all others similarly situated, for their complaint against Defendants Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP,



PricewaterhouseCoopers LLP, Grant Thornton LLP, and BearingPoint, Inc. (formerly known as KPMG Consulting, Inc.) (collectively the "Defendant Firms"); and Susan Alexander, Jeffrey Bergeron, Derrick Burks, Sean Daly, Deborah DeHaas, Jeffrey Dobbs, Thomas Ertel, Bradley Gabosch, Marion Gajek, Timothy Hanley, Paul Keglevic, Michael McGuire, Scott Ozanus, Robert Soza, Gail Steinel, and Ronald Weissman, and all others similarly situated (collectively "the Individual Andersen Partner Defendants"); and Larry Gorrell, Terry Hatchett, John Niemann, Jr., Stephen Rogers and Louis Salvatore (collectively "the Andersen Administrative Board Defendants") alleges and states:

INTRODUCTION

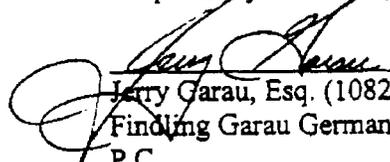
1. This action is commenced on behalf of a class of retired partners of Arthur Andersen LLP ("Andersen") who were also partners of Andersen Worldwide Société Coopérative ("Andersen Worldwide") and who had retired prior to January 1, 2002, were eligible for Basic Retirement Benefits and Early Retirement Benefits, have outstanding balances of Early Retirement Benefits and/or Basic Retirement Benefits, and have not accepted a settlement offer from Andersen pertaining to Basic Retirement Benefits and/or Early Retirement Benefits; their spouses; and the spouses of deceased retired Andersen partners meeting the criteria set forth above who have not accepted a settlement offer from Andersen pertaining to Basic Retirement Benefits and/or Early Retirement Benefits ("the Retired Andersen Partners Class").

S. Such other and further legal and equitable relief as this Court may deem just and proper.

JURY DEMAND

Viets and the Retired Andersen Partner Class hereby demand a trial by jury on all issues so triable.

Respectfully submitted,


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August 18, 2003

*BY DHL COURIER AND
BY FACSIMILE (011-41-22-799-4401)*

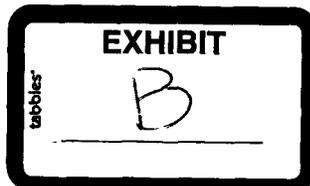
AWSC Société Coopérative, en liquidation
Route de Pré-Bois 29
1215 Genève 15
SWITZERLAND
Attention of Mr. Thomas Rufer, Liquidator

Dear Mr. Rufer:

We represent the retired partners and participating principals of Arthur Andersen LLP ("AA LLP") and Andersen Worldwide Société Coopérative, now AWSC Société Coopérative, en liquidation ("AWSC"), whose names are listed in Annex A to this letter. Our clients have been denied retirement benefits, including, but not limited to, Basic Retirement Benefits, Early Retirement Benefits, repayment of Pro Forma Balances, contributions to their health insurance costs and other benefits described in Andersen Worldwide Policy No. 12. These benefits were due under agreements with, and policies of, AWSC, as well as AA LLP. As you may be aware AA LLP has breached its obligations to make those payments. We believe that AWSC is obligated to make the payments directly to its retired partners and participating principals for a variety of reasons, including the fact that AWSC failed to ensure that AA LLP made the payments, and otherwise failed to fulfill duties AWSC owed the retired partners and participating principals under AWSC's By-Laws, Policies and other agreements and operating documents. The amount due each of our clients also is set forth in Annex A to this letter.

We are writing for several purposes. First, since AWSC is in liquidation, we ask that you treat this letter and its Annex A as a creditor's demand to be paid in liquidation. Second, we wanted to determine if AWSC is willing to make the payments.

If not, we request that AWSC enter into a tolling agreement that would extend the time within which our clients must commence any actions against AWSC to recover their losses. As you likely know, we have commenced a class action against the final



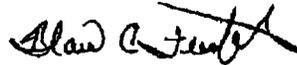
AWSC Société Coopérative, en liquidation
Attention of Mr. Thomas Rufer, Liquidator
August 18, 2003
Page 2

administrators of AA LLP, a number of its former partners and AA LLP's successors, Deloitte & Touche, Ernst & Young, KPMG, PricewaterhouseCoopers, Grant Thornton and BearingPoint. Pending the outcome of that action, our clients would be willing to forego suing AWSC. However, in order to protect their interests, our clients would need to have a tolling agreement that prevents any applicable statute of limitations from running during this forbearance period.

Should AWSC not be willing to enter into a mutually acceptable tolling agreement, we have retained Geneva counsel to file debt collection forms (réquisitions de poursuite) with the appropriate Swiss authorities and will be prepared to file them promptly.

Accordingly, we ask that you or your counsel contact us to let us know whether AWSC is willing to make the payments set out in Annex A or enter into a tolling agreement. We look forward to hearing from you promptly. Please direct any inquiries or correspondence regarding these claims to the undersigned.

Sincerely,



Blair C. Fensterstock

ANNEX A

**CLAIMS OF CERTAIN RETIRED PARTNERS AND PARTICIPATING PRINCIPALS OF
AWSC AS OF AUGUST 18, 2003 (CLAIM AMOUNT DOES NOT INCLUDE INTEREST
ACCRUED SINCE DECEMBER 1, 2002, ALSO CLAIMED TO BE DUE)**

1	Allen	James	1,548,000
2	Austermiller	Larry	1,389,000
3	Banwart	Leslie	1,249,000
4	Barlow	Kenneth	864,000
5	Basler	John	1,114,000
6	Bavolek	Allan	1,077,000
7	Belfi	John	793,000
8	Brown	R. Richard	1,877,000
9	Brown	Richard E.	785,000
10	Bryce	Ronald	1,157,000
11	Buchholz	David	1,385,000
12	Burnett	William	1,569,000
13	Busching	Dean	485,000
14	Callahan	James	2,876,000
15	Campbell	Nicholas	623,000
16	Cardin	Richard	944,000
17	Carlson	Burton	932,000
18	Carman	William	1,524,000
19	Carmichael	Wiley	2,816,000
20	Caso	Ronald	835,000
21	Cetraro	Ronald	2,755,000
22	Chaney	Ronald	640,000
23	Cherin	John	2,062,000
24	Christensen	Dean	675,000
25	Cohen	David	3,173,000
26	Cooper	Timothy	2,326,000
27	Counts	Richard	1,150,000
28	DeBiasi	Gerard	689,000
29	DeFreece	Michael	3,016,000
30	Dennard	Charles	739,000
31	Dickman	Marvin	790,000
32	Dillon	William	856,000
33	Duffy	Margaret	2,755,000
34	Durbin	Timothy	1,878,000
35	Ekdahl	Jon	4,213,000
36	Ellis	Richard	2,654,000
37	Elmore	Robert	1,573,000
38	Ewoldt	James	791,000
39	Floyd	Kim	1,887,000
40	Portson	Milton	560,000
41	Pulscher	Mitchell	2,506,000
42	Gagel	Michael	896,000
43	Ganis	Harvey	1,773,000
44	Garcia	Jose	750,000
45	Giesler	Charles	983,000
46	Gower	Hugh	878,000
47	Haner	John	2,402,000
48	Hanslik	Edward	805,000
49	Hardy	William	1,138,000

ANNEX A
CLAIMS OF CERTAIN RETIRED PARTNERS AND PARTICIPATING PRINCIPALS OF
AWSC AS OF AUGUST 18, 2003 (CLAIM AMOUNT DOES NOT INCLUDE INTEREST
ACCRUED SINCE DECEMBER 1, 2002, ALSO CLAIMED TO BE DUE)

50	Harre	Kenneth	706,000
51	Harrill	Roy	1,904,000
52	Hershberger	Roy	1,487,000
53	Hevey	Albert	647,000
54	Hoff	Harold	980,000
55	Hoffman	Paul	1,256,000
56	Holland	Bill	2,350,000
57	Holmes	Alexander	804,000
58	Huelsmann	Richard	2,105,000
59	Hutchens	John	1,797,000
60	Jacobs	Douglas	1,516,000
61	Jasper	John	907,000
62	Johnson	Albert	924,000
63	Johnson	Byron	1,882,000
64	Jonas	Francis	1,029,000
65	Jose	Stewart	1,345,000
66	Kadet	Jeffery	2,585,000
67	Kelley	Robert	625,000
68	Kelly	Thomas	811,000
69	Klein	Earl	2,366,000
70	Konvalinka	John	170,000
71	Kralovetz	Robert	2,398,000
72	Krimock	Andrew	1,225,000
73	Kullberg	Dnane	718,000
74	LaBorde	James	1,147,000
75	Lewis	John	2,893,000
76	Mangieri	Gerard	3,259,000
77	Massura	Edward	1,489,000
78	May	Robert	499,000
79	McArdle	Richard	721,000
80	McDowell	Larry	1,687,000
81	McKinley	Gary	2,807,000
82	Measelle	Richard	2,294,000
83	Miley	James	631,000
84	Miller	James	3,180,000
85	Moeller	George	711,000
86	Moll	Cletus	2,124,000
87	Moore	Arnold	921,000
88	Morrison	Dan	881,000
89	Munger	Cynthia	931,000
90	Nace	James	2,336,000
91	Park	Joseph	629,000
92	Patterson	William	1,345,000
93	Pesce	Peter	2,417,000
94	Philip	Robert	846,000
95	Reed	John	1,252,000
96	Regner	Robert	514,000
97	Roseman	Jordan	2,580,000
98	Roussey	Robert	954,000

ANNEX A
CLAIMS OF CERTAIN RETIRED PARTNERS AND PARTICIPATING PRINCIPALS OF
AWSC AS OF AUGUST 18, 2003 (CLAIM AMOUNT DOES NOT INCLUDE INTEREST
ACCRUED SINCE DECEMBER 1, 2002, ALSO CLAIMED TO BE DUE)

99	Rudman	Larry	1,449,000
100	Savoie	Vernon	2,929,000
101	Schmal	Dennis	1,732,000
102	Schroeder	Donald	456,000
103	Schwarz	Michael	769,000
104	Silvey	Larry	619,000
105	Sims	Curtis	2,361,000
106	Snyder	Leslie	817,000
107	Starkey	Richard	679,000
108	Starr	David	879,000
109	Summerour	William	1,676,000
110	Swanson	Richard	760,000
111	Niedemann	William	1,003,000
112	Toothman	Michael	1,924,000
113	Torbett	John	771,000
114	Tucei	Walker	2,422,000
115	Turk	George	1,762,000
116	Uhing	Roman	714,000
117	Viets	Gilbert	3,095,000
118	VonDeylen	Gerald	859,000
119	Wade	Ronald	1,106,000
120	Waters	Duane	2,193,000
121	Waters	John	3,203,000
122	Welch	Michael	1,918,000
123	Wells	Rodney	1,495,000
124	West	Jerry	697,000
125	White	Howard	840,000
126	Wilson	Lawrence	2,676,000
127	Winter	John	1,744,000
128	Wright	Howard	599,000
129	Wright	Donald	696,000

FENSTERSTOCK & PARTNERS LLP

30 WALL STREET
NEW YORK, NY 10005
(212) 785-4100
FAX (212) 785-4040
WWW.FENSTERSTOCK.COM

August 28, 2003

**BY UPS COURIER AND
BY FACSIMILE (011-41-22-799-4401)**

AWSC Société Coopérative, en liquidation
Route de Pré-Bois 29
1215 Genève 15
SWITZERLAND
Attention of Mr. Thomas Rufier, Liquidator

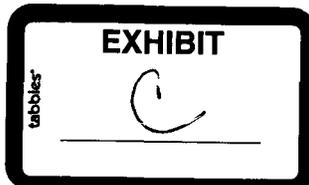
Dear Mr. Rufier:

On August 25, 2003, we requested that you advise us by August 26, close of business, of the intentions of AWSC, en liquidation ("AWSC") regarding our letter of August 18, 2003, failing which we would proceed with the filing of debt collection forms (réquisitions de poursuites) with the appropriate Swiss authorities.

Since we have not heard from you to date, Swiss counsel has proceeded with the filing. You will find attached a copy of the relevant debt collection form, with the stamp of the "Office des Poursuites" dated August 28, 2003. The total amount claimed is CHF 268.108.694 (i.e., US\$ 189,516,289), with interest.

Please be advised that the debt collection procedure has been initiated by one person, Mr. John D. Lewis, to whom all the retired partners and participating principals of Arthur Andersen LLP ("AA LLP") and AWSC listed in the Annex A to our letter of August 18, 2003 have assigned the claims that they hold against AWSC. This letter should serve as notice of that assignment to AWSC. Mr. Lewis has also filed for debt collection to recover amounts owed to him personally.

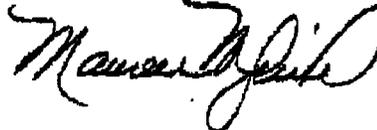
Moreover, we are hereby putting AWSC on notice that we reserve the right to take any steps legally available to secure the recovery of the amounts claimed. This includes, but is not limited to, protective measures relating to the payment that AWSC may have made or may make under the recently reported settlement with the Barron plaintiffs.



AWSC Société Coopérative, en-liquidation
Attention of Mr. Thomas Rufert, Liquidator
August 28, 2003
Page 2

As a final matter, we would like to draw your attention to the fact that, in accordance with Article 917(1) of the Swiss Code of Obligations ("CO"), we can hold you personally liable for any losses that could result from any failure on your part to take the appropriate actions under Articles 743(1) and (2), 913(1) and 903 CO.

Sincerely,



Maureen McGuire

cc: Schellenberg Wittmer

Form. n°1



RÉPUBLIQUE ET CANTON DE GENÈVE
Office des poursuites

Poursuite n°

Parvenue à l'Office le

RÉQUISITION DE POURSUITE

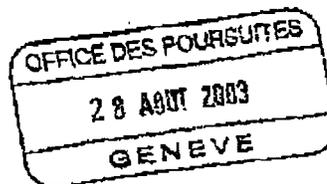
A l'Office des poursuites du canton de Genève

Débiteur: nom, prénom, profession et domicile (indiquer l'adresse exacte, pour les villes, la rue et le numéro)

Monsieur Thomas Rufin, Liquidateur
Andersen Worldwide Société Coopérative, en liquidation
Route de Pré-Bois 29
1215 Genève 15

Créancier (nom, prénom et adresse exacte):

John D. Lewis
19012, Brigadoon Place
Cornelius, North Carolina 28031
U.S.A.



Représentant du créancier (nom, prénom et adresse exacte):

M. Bernard VISCHER
SCHELLENBERG WITTMER
15bis, Rue des Alpes
Case postale 2088
1211 Genève 1

Compte de chèques n° 12-4335-5

Montant de la créance:

- 1) CHF 2907'535.30, plus intérêt au taux annuel de 6,5% dès le 1^{er} décembre 2002
(contre-valeur de USD 2'055'231.- au taux de change de 1,4147 au jour de la réquisition de poursuite);
- 2) CHF 937'395.78, plus intérêt au taux annuel de 6,5% dès le 1^{er} décembre 2002
(contre-valeur de USD 662'611.- au taux de change de 1,4147 au jour de la réquisition de poursuite);
- 3) CHF 246'839.09, plus intérêt au taux annuel de 6,5% dès le 1^{er} décembre 2002
(contre-valeur de USD 174'482.- au taux de change de 1,4147 au jour de la réquisition de poursuite);
- 4) CHF 131'231'513.35, plus intérêt au taux annuel de 6,5% dès le 1^{er} décembre 2002
(contre-valeur de USD 92'762'786.- au taux de change de 1,4147 au jour de la réquisition de poursuite);
- 5) CHF 102'224'136.73, plus intérêt au taux annuel de 6,5% dès le 1^{er} décembre 2002
(contre-valeur de USD 72'258'526.- au taux de change de 1,4147 au jour de la réquisition de poursuite);
- 6) CHF 30'561'273.20, plus intérêt au taux annuel de 6,5% dès le 1^{er} décembre 2002
(contre-valeur de USD 21'602'653.- au taux de change de 1,4147 au jour de la réquisition de poursuite);

Form n°5



REPUBLIQUE ET CANTON DE GENÈVE
Office des poursuites

Poursuite n°

Parvenue à l'Office le

Titre et date de la créance ou cause de l'obligation

Titre et date de la créance :

- 1) Pension de retraite de base (« *Basic Retirement Benefit (BRB)* »), valeur capitalisée au jour de la réquisition de poursuite par calcul actuariel tenant compte de l'espérance de vie, plus intérêts au taux annuel de 6,5% dès le 1^{er} décembre 2002
- 2) Pension de retraite anticipée (« *Early Retirement Benefit (ERB)* ») due au jour de la réquisition de poursuite, plus intérêts au taux annuel de 6,5% dès le 1^{er} décembre 2002
- 3) Autres prestations de retraite garanties selon les directives internes (« *Polices* ») Andersen Worldwide (« *Polices n°12 et 15* »), notamment contribution pour préparation de déclaration fiscale de l'associé et de son conjoint (« *Partner & Spouse Tax Return Prep.* »), contribution assurances maladie et assurance vie (« *Group Medical* » ; « *Group Life* ») et contribution à la location espace bureau et rémunération secrétaire (« *Office Space & Secretarial Help* »), valeur capitalisée au jour de la réquisition de poursuite par calcul actuariel tenant compte de l'espérance de vie, plus intérêts au taux annuel de 6,5% dès le 1^{er} décembre 2002
- 4) Total des pensions de retraite de base (« *Basic Retirement Benefit (BRB)* »), valeur capitalisée au jour de la réquisition de poursuite par calcul actuariel tenant compte de l'espérance de vie, cédées au créancier poursuivant par acte du 26 août 2003 par 128 anciens associés ou directeurs d'Arthur Andersen LLP et/ou coopérateurs d'AWSC, en liquidation, plus intérêts au taux annuel de 6,5% dès le 1^{er} décembre 2002
- 5) Total des pensions de retraite anticipée (« *Early Retirement Benefit (ERB)* ») dues au jour de la réquisition de poursuite, cédées au créancier poursuivant par acte du 26 août 2003 par 128 anciens associés ou directeurs d'Arthur Andersen LLP et/ou coopérateurs d'AWSC, en liquidation, plus intérêts au taux annuel de 6,5% dès le 1^{er} décembre 2002
- 6) Total des autres prestations de retraite garanties selon les directives internes (« *Polices* ») Andersen Worldwide (« *Polices n°12 et 15* ») notamment contribution pour préparation de déclaration fiscale de l'associé et de son conjoint (« *Partner & Spouse Tax Return Prep.* »), contribution assurances maladie et assurance vie (« *Group Medical* » ; « *Group Life* ») et contribution à la location espace bureau et rémunération secrétaire (« *Office Space & Secretarial Help* »), valeur capitalisée au jour de la réquisition de poursuite par calcul actuariel tenant compte de l'espérance de vie, cédées au créancier poursuivant par acte du 26 août 2003 par 128 anciens associés ou directeurs d'Arthur Andersen LLP et/ou coopérateurs d'AWSC, en liquidation, plus intérêts au taux annuel de 6,5% dès le 1^{er} décembre 2002

Cause de l'obligation : Violation d'obligations contractuelles découlant d'un "Agreement Among Partners of Arthur Andersen & Co., Société Coopérative" et de contrats liés, et/ou d'un "Member Firm Interfirm Agreement" et d'Andersen Worldwide "policies"; subsidiairement, violation d'obligations découlant du droit de la société coopérative; subsidiairement acte illicite.

Genève, le 28 août 2003
(Lieu et date)

Escq

Bernard VIECHER

(Signature du créancier ou de son représentant)

Av. Stg

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Only the Westlaw citation is currently available.

United States District Court,
S.D. New York.

Ezequiel Edmond NASSER et al., Plaintiffs,
v.
ANDERSEN WORLDWIDE SOCIETE
COOPERATIVE a/k/a Andersen Worldwide,
Defendant.

No. 02 Civ. 6832(DC).

Sept. 23, 2003.

Srouer Fischer & Mandell, LLP, By Barry R. Fischer,
Esq., Audrey I. Dursht, Esq., Mitchell G. Mandell,
Esq., New York, NY, for Plaintiffs.

Sidley Austin Brown & Wood LLP, By James J.
Sabella, Esq., Steven E. Klein, Esq., New York,
NY, for Defendant.

CHIN, D.J.

*1 In this case, plaintiffs sue defendant for damages under the Racketeering Influenced and Corrupt Organizations Act ("RICO"). None of the relevant contacts, however, were in the United States. Rather, all the key events occurred in Brazil, Spain, or Switzerland. Hence, defendants move to dismiss, *inter alia*, for lack of subject matter jurisdiction, arguing that RICO does not apply to wholly foreign transactions. For the reasons that follow, the motion is granted.

STATEMENT OF THE CASE

A. The Facts

As alleged in the complaint, the facts are as follows:

Plaintiffs were controlling shareholders in Banco Excel Economico S.A. ("Excel"), a Brazilian bank subject to regulation by Banco Central of Brazil (the "Central Bank"). (Compl. ¶¶ 3-7, 31). Plaintiffs are Brazilian, comprised of individuals who are citizens and residents of Brazil and one Brazilian corporation. (*Id.* ¶¶ 3-7). Banco Bilbao Viscaya Argentaria S/A ("BBVA"), not named as a

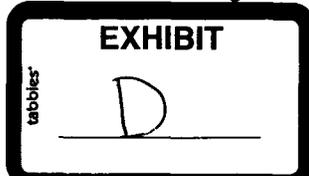
defendant in this case but with whom defendant is alleged to have conspired, is a Spanish bank. (*Id.* ¶ 26).

The complaint is confusing as to the identity of the defendant. The caption identifies the defendant as "Andersen Worldwide Societe Cooperative a/k/a Andersen Worldwide." The introduction, however, refers to wrongful conduct by "Arthur Andersen, at the time, the world's preeminent accounting and auditing firm." Paragraph 9 of the complaint alleges that "[d]efendant Andersen Worldwide was, at the time of the events alleged herein, a Swiss cooperative entity with a principal place of business and worldwide executive offices in the United States in both New York and Chicago." Paragraph 11 defines the term "Andersen" as meaning "Andersen Worldwide." Paragraph 13 alleges that "Anderson [sic] is comprised of Arthur Andersen & Co. Societe Cooperative ("AWSC"), a Swiss cooperative created as an administrative coordinating entity that operates as an umbrella organization for the partners of AWSC, Andersen member firms ("Member Firms"), the individual partners of Andersen and Andersen's offices around the world." (Parentheses in original). In this memorandum decision, the Court's references to "AWSC" are to defendant "Andersen Worldwide Societe Cooperative," and not "Arthur Andersen & Co. Societe Cooperative" or any other entity. [FN1]

FN1. As AWSC's evidentiary materials make clear, AWSC was created in 1977 and originally was named Arthur Andersen & Co. Societe Cooperative ("Andersen SC"). (*See* Ekdahl Aff. ¶ 5 (attached to Sabella Reply Aff. as Ex. A.); *see also* Sabella Reply Aff. ¶¶ 4, 5). Andersen SC was created to coordinate the professional practices of the separate national practice entities that were affiliates of Arthur Andersen & Co. Each national practice was to be kept separate and autonomous, and Andersen SC did not earn net income, nor did it engage in professional practice. (Ekdahl Aff. ¶¶ 5, 6).

In the first quarter of 1998, BBVA decided to purchase plaintiffs' controlling shares of Excel. (*Id.* ¶ 26). On April 29, 1998, BBVA entered into a

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Letter of Intent ("LOI") with Excel to purchase plaintiffs' shares of Excel. (*Id.* ¶ 29). The purchase price was to be determined based on the value of Excel, after due diligence and valuation by defendant, BBVA's auditors. (*Id.* ¶ 30).

In the end, plaintiffs sold their shares for R\$1, [FN2] far below their value. [FN3] (*Id.* ¶ 54). Plaintiffs contend that they were coerced and defrauded into selling their shares for such a low price. According to plaintiffs, AWSC agreed, at BBVA's request, to create a fraudulent financial report to "drastically devalue Excel so that Plaintiffs could be coerced by threat of Central Bank intervention to sell their Shares for nothing." (*Id.* ¶ 58).

FN2. "R" represents the Brazilian currency--the "real." Plaintiffs allege that on June 28, 1998 US\$1.00 equaled R\$1.15. (Compl. ¶ 27 n. 1).

FN3. Excel's net asset value on June 30, 1998, as determined by its auditors, was R\$686,885,000. (*Id.* ¶ 62).

*2 Plaintiffs allege that defendant's conduct was part of a pattern of racketeering activity, including eleven other "conspiracies" that were "directed, controlled, supervised, monitored, or acquiesced in by Andersen senior partners in New York and/or Chicago ." (*Id.* ¶¶ 76, 79). In addition, the profits "derived by [defendant], either directly or indirectly" from its conduct were "shared in and distributed to Andersen partners worldwide, including in the United States." (*Id.* ¶ 76). In these "criminal conspiracies throughout the world," defendant's partners acted to increase their fees and enrich themselves. (*Id.* ¶¶ 79, 80). Plaintiffs allege that defendant's "pattern of racketeering activity" has had a "profound and negative effect and impact upon financial markets throughout the world and especially in the United States." (*Id.* ¶ 82). United States equity markets, plaintiffs allege, have experienced "dramatic declines ... as a result of the loss of investor confidence in the credibility of reports of corporate earnings based upon" defendant's accounting and audit services. (*Id.*).

These are the only contacts alleged in the United

States. All the key players are foreign and all the critical facts--the meetings, the execution of the LOI, the valuation and due diligence, and the sale of the shares--took place outside the United States.

B. Procedural History

Plaintiffs filed their complaint on August 27, 2002. Defendant moves to dismiss, arguing lack of subject matter jurisdiction, lack of personal jurisdiction, forum non conveniens, and failure to state a claim against defendant and under RICO. As I conclude that defendant's motion to dismiss should be granted based on lack of subject matter jurisdiction, I do not address the remaining grounds.

DISCUSSION

A. Applicable Law

1. Subject Matter Jurisdiction

In considering a motion to dismiss for lack of subject matter jurisdiction under Rule 12(b)(1), federal courts "need not accept as true contested jurisdictional allegations." *Jarvis v. Cardillo*, No. 98 Civ. 5793(RWS), 1999 U.S. Dist. LEXIS 4310, at *7 (S.D.N.Y. Apr. 5, 1999). Rather, a court may resolve disputed jurisdictional facts by referring to evidence outside the pleadings, including affidavits. *See Zappia Middle E. Constr. Co. v. Emirate of Abu Dhabi*, 215 F.3d 247, 253 (2d Cir.2000); *Filetech S.A. v. France Telecom S.A.*, 157 F.3d 922, 932 (2d Cir.1998). As the party "seeking to invoke the subject matter jurisdiction of the district court," the plaintiff bears the burden of demonstrating that there is subject matter jurisdiction in the case. *Scelsa v. City Univ. of New York*, 76 F.3d 37, 40 (2d Cir.1996).

2. RICO

The Second Circuit has noted that "[t]he RICO statute is silent as to any extraterritorial application." *North South Fin. Corp. v. Al-Turki*, 100 F.3d 1046, 1051 (2d Cir.1996). Although "a corporate defendant that is a foreign entity is not for that reason alone shielded from the reach of RICO," the Second Circuit has acknowledged ambiguity as to the "character and amount of activity in the United States that will justify RICO subject matter jurisdiction over a foreign entity." *Id.* at 1052 (citing *Alfadda v. Fenn*, 935 F.2d 475, 479 (2d Cir.1991)). The Second Circuit has noted that

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"guidance [regarding the extraterritorial application of RICO] is furnished by precedents concerning subject matter jurisdiction for international securities transactions and antitrust matters." *North South Fin.*, 100 F.3d at 1052.

*3 The Second Circuit, however, has not specified the test for extraterritorial applications of RICO. In dicta in *North South Fin.*, the court expressed ambivalence about the relevance to RICO of securities--or antitrust-based standards, in light of differing congressional intent behind the various statutes involved. *Id.* at 1052. "The ultimate inquiry is ... whether 'Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to [foreign transactions] rather than leave the problem to foreign countries.'" *Id.* at 1052 (quoting *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir.1975)).

Although the Second Circuit has not specified a precise standard, in RICO extraterritoriality cases courts in this circuit have generally applied two alternative tests derived from transnational and antitrust cases--the "conduct" and "effects" tests. See *North South Fin.*, 100 F.3d at 1051-52 (affirming district court's dismissal of RICO action for lack of subject matter jurisdiction for absence of U.S. conduct material to fraud); *Wiwa v. Royal Dutch Petroleum Co.*, No. 96 Civ. 8386(KMW), 2002 WL 319887, at *21 (S.D.N.Y. Feb. 28, 2002); *Giro v. Banco Espanol De Credito, S.A.*, No. 98 CIV.6195(WHP), 1999 WL 440462, at *2 (S.D.N.Y. June 28, 1999), *aff'd*, 208 F.3d 203 (2d Cir.2000); *Madanes v. Madanes*, 981 F.Supp. 241, 250 (S.D.N.Y.1997).

Under the conduct test, subject matter jurisdiction exists "only where conduct material to the completion of the fraud occurred in the United States." *Giro*, 1999 WL 440462, at *3 (citing *Alfadda*, 935 F.2d at 479); see also *Madanes*, 981 F.Supp. at 251; but see *C.A. Westel de Venezuela v. Am. Tel. & Tel. Co.*, No. 90 Civ. 6665(PKL), 1993 WL 497971, at *4 (S.D.N.Y.1993) (rejecting conduct and effects tests in RICO context but asserting jurisdiction because predicate acts occurred in U.S.). The conduct in the United States must have "directly caused" the loss for subject matter jurisdiction to exist. *North South Fin.*, 100 F.3d at 1050 (citing *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1046 (2d Cir.1983) (quoting *Bersch*,

519 F.2d at 993)). "Mere preparatory activities, and conduct far removed from the consummation of the fraud, will not suffice to establish jurisdiction." *North South Fin.*, 100 F.3d at 1051 (quoting *Psimenos*, 722 F.2d at 1046)). As for the effects test, two versions exist--one in the securities and the other in the antitrust context. *North South Fin.*, 100 F.3d at 1051-52. Under the effects test borrowed from securities cases, jurisdiction exists over a predominantly foreign transaction when it has "substantial effects within the United States." *North South Fin.*, 100 F.3d at 1051; see also *Giro*, 1999 WL 440462, at *3; *Madanes*, 981 F.Supp. at 250 (quoting *Consol. Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252, 261-62 (2d Cir.1989)). "Remote and indirect effects" do not qualify as substantial. *North South Fin.*, 100 F.3d at 1052. The "effect" must be a "direct and foreseeable result" of the conduct alleged. *Consol. Gold Fields*, 871 F.2d at 261-62. In antitrust cases, liability may attach when the extraterritorial conduct is "intended to and actually does have an effect on United States imports or exports which the state reprehends." *North South Fin.*, 100 F.3d at 1052. Under both versions of the effects test, "the reasoning behind the test is 'to protect ... domestic markets from corrupt foreign influences.'" *Wiwa*, 2002 WL 319887, at *21 (quoting *Madanes*, 981 F.Supp. at 250)).

B. Application

*4 AWSC contends that RICO does not confer subject matter jurisdiction, as alleged by plaintiffs, because it is a foreign entity that has allegedly engaged in conduct violating RICO on foreign soil against foreign victims. (Def.Mem.6). AWSC argues that plaintiffs have failed to allege sufficient U.S. conduct or effects to justify extraterritorial application of RICO against a foreign party. (*Id.* 6-9).

Plaintiffs maintain, however, that this case does not involve the extraterritorial application of RICO, arguing that, in fact, AWSC is a not a foreign entity but a worldwide organization based in the U.S. (Pl.Mem.8-10). Plaintiffs argue, alternatively, that even if AWSC were treated as a foreign entity, they have made sufficient allegations of U.S. conduct and effects to confer subject matter jurisdiction. (*Id.* 10-12).

For the reasons stated below, I conclude that plaintiffs have failed to establish subject matter

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jurisdiction.

1. Is Defendant a Foreign Entity?

As a preliminary matter, I consider whether AWSC is a foreign or domestic entity. Plaintiffs concede that AWSC is a Swiss cooperative. (Compl. ¶ 9). Nonetheless, plaintiffs maintain that this case does not involve the extraterritorial application of RICO because defendant is a worldwide, unified entity that includes Andersen-Brazil and has U.S. offices. (Pl. Mem. 8; Compl. ¶ 9; Fischer Decl. ¶¶ 52-56; PX 25; PX 26). [FN4] Plaintiffs allege that AWSC or "Andersen Worldwide," as they also refer to defendant, is comprised of AWSC and "Andersen member firms, the individual partners of Andersen and Andersen's offices around the world." (Compl. ¶ 13). These offices around the world include those of U.S. member firms. (*Id.* ¶ 15). In addition, plaintiffs allege that AWSC and its U.S. member firms are "closely intertwined." (*Id.* ¶ 18).

FN4. "PX" refers to plaintiffs' exhibits to the Declaration of Barry R. Fischer accompanying Plaintiffs' Memorandum of Law in Opposition to Defendant's Motion to Dismiss.

Plaintiffs rely on a 1995 Chicago Tribune article discussing a recent shift in office space for "Arthur Andersen & Co." and "Andersen Worldwide" within the Chicago area. (Pl. Mem. 9; Fischer Decl. ¶¶ 8, 52-57; PX 25). Plaintiffs additionally refer to a 1998 Client Service Directory of "Andersen Worldwide" (PX 26) to establish that AWSC professionals, partners, and officers worked out of AWSC offices in Chicago and New York. (Pl. Mem. 8; Fisher Decl. ¶¶ 8, 52- 57).

Plaintiffs' evidence fails to establish that AWSC itself has a U.S. presence. The 1995 article and the 1998 Client Services Directory refer not to the AWSC, but to "Andersen Worldwide" or "Arthur Andersen & Co." (PX 25, 26). Any assertion that "Arthur Andersen & Co." has U.S. offices is irrelevant to determining whether AWSC has a U.S. presence. Furthermore, references to the offices of "Andersen Worldwide" does not establish AWSC's presence in the U.S., for the complaint alleges that "Andersen Worldwide" refers to entities beyond AWSC. (Compl. ¶ 13).

Moreover, to the extent plaintiffs rely on assertions that other "Andersen" entities, i.e., Andersen member firms, may be linked to AWSC to establish AWSC's domestic presence for subject matter jurisdiction purposes, these assertions are refuted by the evidentiary materials presented. AWSC was created to coordinate administratively the separate and autonomous national practice entities affiliated with Arthur Andersen & Co. (Ekdahl Aff. ¶ 5, 6; Sabella Reply Aff. ¶¶ 4, 5). AWSC does not engage in professional practice, nor does it earn net income. (Ekdahl Aff. ¶¶ 5). Accordingly, any alleged U.S. presence of Andersen member firms may not be imputed to AWSC to establish AWSC's domestic connection. Hence, I conclude that AWSC is a foreign entity.

*5 Even assuming arguendo that AWSC has U.S. offices, such contacts would not confer subject matter jurisdiction automatically. *See IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1016 (2d Cir.1975); *Bersch*, 519 F.2d at 985; *Fidenas AG v. Honeywell, Inc.*, 501 F.Supp. 1029, 1041 (S.D.N.Y.1980). In the transnational securities context, from which courts have sought guidance for the extraterritorial application of RICO, a defendant's U.S. citizenship or U.S. presence alone has been deemed insufficient to confer subject matter jurisdiction without additional connections, such as U.S. conduct or effects. *IIT*, 519 F.2d at 1016 (deeming control over other defendants by U.S. citizen defendant insufficient to establish subject matter jurisdiction: "It is simply unimaginable that Congress would have wished the anti-fraud provisions of the securities laws to apply if, for example, [a U.S. citizen defendant] while in London had done all the acts here charged and had defrauded only European investors."); *Bersch*, 519 F.2d at 985, 986-90 (examining U.S. conduct and effects, even where defendants included U.S. citizens); *Fidenas*, 501 F.Supp. at 1041 (holding lack of subject matter jurisdiction in absence of U.S. conduct or effects by U.S.-based defendants). Accordingly, even accepting plaintiffs' allegations of AWSC's U.S. presence as true, such connections would be insufficient to confer subject matter jurisdiction without U.S. conduct or effects.

2. Does RICO Apply Here?

In light of the predominantly foreign nature of this action, this Court must determine whether RICO confers subject matter jurisdiction extraterritorially.

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I hold that it does not, for plaintiffs fail to satisfy the conduct test or either version of the effects test.

Plaintiffs do not allege any facts of U.S. conduct "material to the completion of the fraud." *Giro*, 1999 WL 440462, at *3. The complaint contains allegations about defendant's U.S. conduct in only one paragraph. (Compl. ¶ 76). Plaintiffs allege that defendant engaged in a "pattern of racketeering activity ... which, upon information and belief, was either directed, controlled, supervised, monitored, or acquiesced in by Andersen senior partners in New York and/or Chicago." (*Id.* ¶ 76). Plaintiffs' conclusory allegation, however, is strikingly devoid of any specific, supporting facts. Plaintiffs do not identify what conduct material to the fraud occurred in the United States. In fact, all the material conduct is alleged to have occurred outside the United States.

Furthermore, plaintiffs fail sufficiently to allege effects in the United States resulting from defendant's conduct. Plaintiffs allege that U.S. effects arose in two ways: (1) profits derived "either directly or indirectly" from defendant's acquisition of Excel were shared with defendant's partners, including those in the United States, "upon information and belief"; or (2) defendant's conduct has had "a profound and negative effect and impact upon the financial markets throughout the world and especially in the United States," manifested in the "recent dramatic declines in United States equity markets as a result of the loss of investor confidence in the credibility of reports of corporate earnings based on [defendant's] accounting and audit services." (*Id.* ¶¶ 76, 82).

*6 Plaintiffs fail both variations of the effects test. Plaintiffs' allegations of profit-sharing and market effect are insufficient to meet the securities-based requirement for "substantial effects." *North South Fin.*, 100 F.3d at 1051. First, plaintiffs again offer only a vague, conclusory statement regarding profit-sharing without any specific, factual allegations. Moreover, as pled by plaintiffs, the profits allegedly shared in the United States are far from direct effects of defendant's conduct, allegedly derived "either directly or indirectly." (Compl. ¶ 76). See *North South Fin.*, 100 F.3d at 1051. Second, the allegedly "generalized effects" on the U.S. market are insufficient to meet the requirement for "substantial effects." *Bersch*, 519 F.2d at 987-88 (holding that allegations of market decline both in U.S. and abroad, resulting from "deterioration of

investor confidence" due to securities fraud, were insufficient to confer subject matter jurisdiction over suit by foreign plaintiff).

Moreover, plaintiffs' allegations fall far short of the antitrust-based effects test, which requires that the defendant's conduct be intended to and actually have an effect in the United States. *North South Fin.*, 100 F.3d at 1052; *Wiwa*, 2002 WL 319887, at *21. Plaintiffs fail to allege anywhere in the complaint that AWSC intended, through its alleged conduct, to create in the U.S. the partner profits or market effects alleged. See *Wiwa*, 2002 WL 319887, at *22 (holding that plaintiffs met effects test based, *inter alia*, on allegations that defendants "had the 'intention to gain significant competitive advantage' in the United States through their racketeering activities"). Nor have plaintiffs alleged or shown any actual material effects in the United States.

In addition to plaintiffs' failure to satisfy either the conduct or effects tests, this Court lacks subject matter jurisdiction because this matter is not one to which U.S. resources should be devoted, given the exclusively foreign nature of the transactions in question. *North South Fin.*, 100 F.3d at 1052. *North South Fin.* involved criminal RICO allegations based on facts strikingly similar to those in this case. There, the foreign plaintiffs were holding companies and their stockholders who eventually sold their ownership stake in a French bank to two French investment banking groups. *Id.* at 1048-49. The defendants allegedly forced the sale of the bank at a fraudulently undervalued price. *Id.* The plaintiffs alleged that the defendants "artificially depressed the sale price of [the French bank] by corrupting the bank's general manager in Paris, who then understated the bank's liquidity for financial and regulatory purposes and misused information drawn from company sources (including a New York office)." *Id.* at 1048. Arthur Andersen & Co., not named as a defendant, prepared an audit report for the defendants that "falsely understated" the French bank's net worth. *Id.* at 1049. The defendants then used the audit report to create "regulatory pressure in France that was calculated to force the sale of [the bank] and to drive down the purchase price." *Id.* The plaintiffs further alleged that the defendants manipulated post-sale transactions, some in New York, so that contingent payments of the purchase price on high risk loans were not apportioned to the plaintiffs and were

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instead fraudulently reduced or eliminated. *Id.* at 1048-49.

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*7 While affirming the district court's holding that it did not have subject matter jurisdiction due to a dearth of U.S. conduct material to the fraud's completion, the Second Circuit noted that subject matter jurisdiction was also lacking in light of the policy concerns implicated in cases involving the extraterritorial application of RICO. *Id.* at 1052. Specifically, the court highlighted the inquiry into "whether 'Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to [foreign transactions] rather than leave the problem to foreign countries.' " *Id.* at 1052. The court concluded, "we have no doubt that the district court was without jurisdiction over a controversy involving foreign victims who sold a foreign entity to foreign defrauders in a foreign transaction lacking significant and material contact with the United States." *Id.*

This reasoning applies with equal—if not more—force here. As in *North South Fin.*, the parties and key non-parties in this case are all foreign. Furthermore, while the transaction in *North South Fin.* was connected in part to the United States, plaintiffs in the case at bar have failed to allege with any sufficiency any wrongful domestic conduct. Accordingly, the policy considerations raised in *North South Fin.* further support the conclusion that this Court lacks subject matter jurisdiction over the instant matter.

Because I have concluded that this Court does not have subject matter jurisdiction over this case, I do not address defendant's remaining proposed grounds for dismissal. *Rhulen Agency v. Alabama Ins. Guar. Ass'n*, 896 F.2d 674, 678 (2d Cir.1990).

CONCLUSION

For the reasons set forth above, defendant's motion is granted and the complaint is dismissed for lack of subject matter jurisdiction. The Clerk of the Court shall enter judgment accordingly and this case shall be closed.

SO ORDERED.

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

IN RE

DeLOREAN MOTOR COMPANY LITIGATION,

MDL Docket No. 559

SIDNEY J. RUDOLPH, et al.,

Plaintiffs,

E.D. Mich. Docket
No. 83-CV-2137-DT

v.

JOHN Z. DeLOREAN, et al.,

HON. GEORGE E. WOODS

Defendants.

OPINION AND ORDER GRANTING IN PART AND
DENYING IN PART PLAINTIFFS' AND DEFENDANT
OPPENHEIMER & CO.'S MOTIONS TO COMPEL

AT A SESSION of said Court, held in the
United States Courthouse, in the City of
Detroit, State of Michigan, on the 19th
day of November, 1985.

PRESENT: THE HONORABLE GEORGE E. WOODS
United States District Judge

This matter is before the Court on plaintiffs' Motion to
Compel the production of documents by non-party Arthur Andersen &
Co. ("Andersen") and on a similar motion filed by defendant Oppenheimer
& Co. The documents at issue were requested by way of an amended
subpoena served upon Andersen on July 11, 1985 and were described
therein as follows:

All documents, records, memoranda or writings of any
kind relating to the entities described below, all
predecessors and successors thereto and affiliates
thereof:

EXHIBIT

E

tabbles

1. DeLorean Motor Company
2. DeLorean Research Limited Partnership
3. Composite Technology Corporation
4. DeLorean Manufacturing Company, f/k/a John Z. DeLorean Corporation
5. DeLorean Motor Cars, Ltd.
6. DeLorean Motor Company, Inc., f/k/a DeLorean, Ltd.
7. CHRISTINA [sic], a Nevada Corporation
8. Logan Manufacturing Corporation

for the period January 1, 1975 to date.

* * * * *

Such documents should include, but not be limited to, accounting books and records, client documents and correspondence, bank statements, communications between Arthur Andersen and third parties relating to the entities described above, as well as communications between Arthur Andersen and the above-referenced entities including attorneys' responses to auditor's letters, financial statements, audit files, audit working papers and supporting documentation. Such documents should include documents and work papers generated by Arthur Andersen & Co. and those in the custody of Arthur Andersen & Co. which are the property of the clients. Documents produced pursuant [sic] to Plaintiffs' October 17, 1983 subpoena need not be produced again.

Exhibit 1, Exhibits of Memorandum of Law in Support of Plaintiffs' Motion to Compel. (Hereinafter "Plaintiffs' Exhibit ____").

A similar subpoena was issued by defendant Oppenheimer & Co., Inc., at about the same time (Plaintiffs' Exhibit 2). Neither subpoena was honored, as Andersen responded instead with the following objections:

^{1/} Except for the omission of grounds 2 and 3, Andersen's objections to the Oppenheimer subpoena were identical. The Oppenheimer subpoena is the subject of a similar motion to compel, and the resolution of the instant motion is dispositive of Oppenheimer's. Before becoming aware that the two motions were virtually identical, the Court also ordered Oppenheimer's motion submitted on the briefs, but because it was filed later, called for any response thereto to be submitted by December 2, 1985. In view of the instant disposition, any further consideration of that motion is unnecessary. The parties' expected agreement with this conclusion is demonstrated by Andersen's having referred in their response to the motions to compel in the plural.

1. The subpoena purports to require wholesale production of all files related in any way to eight companies affiliated with John Z. DeLorean, regardless of whether the documents covered thereby bear any relation to plaintiffs, DeLorean Research Limited Partnership ("DRLP") or the issues in this action. Accordingly, the subpoena is overly broad and oppressive, and compliance therewith would be unduly burdensome.
2. This is the second subpoena duces tecum in this action served by plaintiffs on Andersen. In connection with the prior subpoena, counsel for plaintiffs and counsel for Andersen stipulated and agreed that production of certain specified files would constitute full compliance with such subpoena. Those specified files were produced. The current subpoena, calling for many of the same documents called for by the first, including those whose production was waived, is thus unduly oppressive and harassing, and also violates the stipulation and agreement of counsel respecting compliance with the first subpoena.
3. Presently pending in the United [sic] States District Court for the Southern District of Florida is an action by plaintiffs against Andersen, styled Rudolph v. Arthur Andersen & Co., No. 84-0748 (S.D. Fla.) In such action, by virtue of certain motions to dismiss and for protective orders filed by Andersen and presently pending before the Court, discovery has not gone forward. Plaintiffs appear to seek to take discovery in this action for use in such other action against Andersen, which constitutes a misuse of the discovery process.
4. The documents sought by the subpoena contain or reflect various trade secrets, proprietary or confidential information, or other material which should not be disclosed without restrictions on its use. Therefore, the documents sought should not be produced in the absence of an appropriate protective order limiting their use to purposes of this action.
5. The documents sought are subject to claims against production by Andersen's clients based on, inter alia, section 7509 of the Internal Revenue Code and the accountant-client privilege. Production should not be made absent consent by said clients.

- 6. Certain of the documents sought by the subpoena are not within Andersen's possession, custody or control but are in the possession, custody or control of separate partnerships abroad using the Arthur Andersen & Co. name. Accordingly, Andersen cannot be required to produce such documents.
- 7. Many of the documents sought by the subpoena are located at Andersen's offices in cities in the United States other than Detroit. Requiring production of such documents in Detroit would be unduly burdensome and oppressive.

Plaintiffs' Exhibit 3.

Andersen's response to plaintiffs' motion indicates that it has withdrawn its Objection No. 5 set out above because "those persons presently controlling the affairs of Andersen's audit clients -- the liquidators and/or bankruptcy trustees of the various DeLorean companies -- appear to have waived any accountant-client privilege and have not asserted objection to production of the documents." (Memorandum of Arthur Andersen & Co. in Opposition to Motions to Compel at 16). Consequently, the discussion which follows will not address this abandoned objection.

As to Andersen's first objection, plaintiffs point out that Andersen served as the auditors and financial advisors to DMC and each of its related entities since the inception of the DMC venture in 1975. In view of plaintiffs' position that each of these entities played a part in the fraud allegedly perpetrated against them, the information plaintiffs seek appears reasonably calculated to lead to the discovery of admissible evidence and the Court is thus satisfied

that the documents at issue are discoverable. Further, Andersen's first objection on the grounds of overbreadth would be more proper coming from the defendants in this action, but even then such an argument could not prevail.

Plaintiffs' and Andersen's discussion of Andersen's second objection has generated much heat, but little light. The Court is prepared to cut through all the invective, however, and conclude that this objection does not require the denial of plaintiffs' motion. Andersen's insistence that it had an agreement with plaintiffs such that production of the DRLP audit files would satisfy its obligations under the October 17, 1983 subpoena is not established conclusively in the record before the Court. It is true that Andersen's attorney, James J. Sabella, wrote to Peter J. Yanowitch, plaintiffs' counsel, on November 9, 1983 and stated that he was enclosing "copies of Arthur Andersen & Co.'s audit files for the DeLorean Research Limited Partnership, numbered 00000 through 01526, production of which we have agreed will satisfy Andersen's obligations under the subpoena . . ." (Affidavit of James J. Sabella, Exhibit 1 (emphasis added)). However, it also appears that Yanowitch responded by letter of November 9, 1983 and, after referring to the documents mentioned in Sabella's November 9 letter, stated: "I would also appreciate your providing me with copies of the other documents requested at your earliest convenience," (Plaintiffs' Exhibit 8). While this particular paper trail ends with a November 14, 1983 letter from Sabella repeating his conviction that "we do not feel that Andersen has further responsibilities under the

subpoena," (Plaintiffs' Exhibit 9), the Court is not persuaded that Andersen "[h]aving bought its peace . . . should be permitted . . . to be left alone." Dart Industries Company, Inc. v. Westwood Chemical Company, Inc., 649 F.2d 646, 650 (9th Cir. 1980). Even dismissing for the moment this Court's conviction that the dissent in Dart is correct, Andersen's reliance on that case is not persuasive. While there was some ambiguity to the release at issue in Dart, at least there was a writing signed by the party to be charged with having given up the right to discovery. In this case, there is a letter from Andersen, a denial by plaintiffs and a further claim from Andersen that it has fulfilled its obligations under the subpoena. In the absence of an unequivocal agreement between the parties, this Court is not inclined to thwart the spirit of the Federal Rules of Civil Procedure by artificially curtailing any party's right to discovery.

Andersen's third objection provides no grounds for the outright denial of these motions to compel either. The argument that "federal courts have in countless cases ordered that materials produced in discovery be used only in connection with the action in which they are produced and not for some ulterior purpose" overlooks the fact that most such orders were issued to protect the recipient of a discovery request from having such discovery shared with other potential plaintiffs or competitors. See, e.g., National Utility Services, Inc. v. Wisconsin Centrifugal Foundry, Inc., 49 F.R.D. 30, 32 (E.D. Wisc. 1970). The restrictions Andersen seeks in this case would amount to requiring plaintiffs to sign a covenant not to sue in the event such discovery

discloses any actionable misconduct on the part of Andersen. The Court is not persuaded that such a restriction need be applied here.

Andersen is on much firmer ground in its fourth objection, however. As it stated in its memorandum:

Andersen's Objection No. 4 has nothing to do with the [abandoned] accountant-client privilege [objection]. On the contrary, Objection No. 4 states that the documents demanded contain trade secrets and proprietary or confidential information belonging to Andersen itself. This objection has not been waived, and can only be obviated by an appropriate protective order barring disclosure of confidential information by plaintiffs.

That the documents contain information confidential as to Andersen is evident from the very nature of the documents demanded. Plaintiffs seek audit files and workpapers. Necessarily, such files and workpapers expose the standards used by Andersen in conducting audits, the organization of and distribution of responsibility within an Andersen audit team, and other proprietary information concerning Andersen's professional practice. Disclosure of this information to third parties in the accounting/auditing field would place Andersen at a serious competitive disadvantage.

Memorandum of Arthur Andersen & Co. in Opposition to Motions to Compel at 16-17 (emphasis in original).

The Court agrees that Andersen's compliance with earlier court orders to produce has not extinguished the element of confidentiality and further agrees that some sort of protective order is appropriate. Accordingly, this Court will limit the use of the documents produced in response to this order to the purposes of DeLorean Motor Company related litigation. In setting out the terms of such protective order

In broad fashion, the Court is aware that further fine-tuning might become necessary, a task which the Court will assume upon application by the parties.

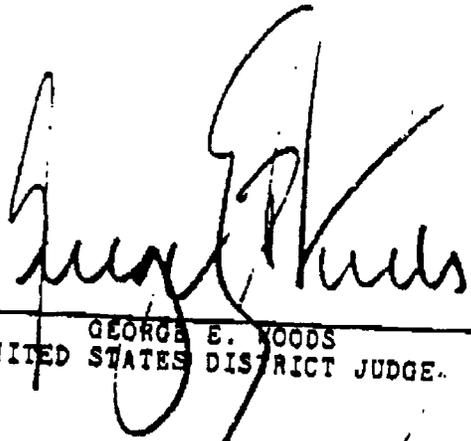
The Court also finds merit to Andersen's sixth objection. From the affidavits of James J. Sabella, Jon N. Ekdahl and Frank P. Henderson, submitted in Andersen's response to these motions to compel, the Court is persuaded that plaintiffs are incorrect in characterizing Andersen as a "single worldwide partnership." The Court thus agrees that ordering the production of documents by Arthur Andersen & Co. in the United Kingdom or Ireland would circumvent the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, 28 U.S.C. §§1781 et seq., and thus this order will only require the production of documents by entities using the Arthur Andersen & Co. name in the United States.

Finally, the Court agrees with Andersen that there is no need to depart from the general rule that the documents at issue should be examined at the places they are kept.

For these reasons, IT IS HEREBY ORDERED that plaintiffs' and defendant Oppenheimer & Co.'s Motions to Compel are hereby GRANTED IN PART and DENIED IN PART. Accordingly, these parties are entitled to the production of documents by entities using the Arthur Andersen & Co. name in the United States only, subject to the restriction that such documents shall not be disclosed to persons or organizations not parties to DeLoorean Motor Company related litigation. Any disclosure

to parties beyond plaintiffs and defendant Oppenheimer & Co. shall not be made until such time as Andersen has been allowed to petition this Court for whatever further restrictions it deems necessary. Production of the documents at issue shall otherwise proceed in accordance with customary practice and procedure and shall be made at the places of their storage.

So ordered.



GEORGE E. WOODS
UNITED STATES DISTRICT JUDGE.

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(Cite as: 1998 WL 122590 (S.D.N.Y.))

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C
Only the Westlaw citation is currently available.

United States District Court, S.D. New York.

Andersen Consulting Business Unit Member Firms,
Petitioners,
v.
Andersen Worldwide Societe Cooperative,
Respondent,
and
Arthur Anderson LLP Intervenor-Respondent.

No. 98 CIV. 1030(JGK).

March 18, 1998.

Barry R. Ostrager, Esq., Peter C. Thomas, Esq.,
Robert H. Smit, Esq., Simpson Thacher & Bartlett,
New York, for the petitioners.

Sheldon Raab, Esq., John Sullivan, Esq., Gregg
Weiner, Esq., Fried Frank Harris Shriver &
Jacobson, New York, for the respondent.

James Quinn, Esq., Mindy Spector, Esq., Weil,
Gotshal & Manges LLP, New York, for the
intervenor-respondent.

OPINION AND ORDER

KOELTL, District J.

*1 This action arises out of a bitter internecine dispute between the Andersen Consulting and Arthur Andersen business units' member firms, who together comprise the Andersen Worldwide Societe Cooperative ("SC"). On December 17, 1997, petitioners Andersen Consulting ("AC") business unit member firms (the "petitioners") commenced an arbitration proceeding before the International Chamber of Commerce (the "ICC") against respondent SC and Arthur Andersen ("AA") business unit member firms in which they seek to separate themselves from the SC and to obtain \$400 million in damages from the SC and the AA member firms. [FN1] In response to the initiation of the ICC proceeding, the governing body of the SC, the Board of Partners, passed a resolution on February 12, 1998 (the "Resolution") which

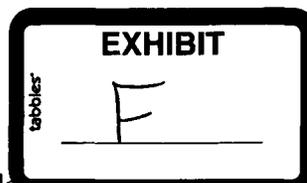
purports to establish a committee to determine the measures the SC should take to protect the SC and the AA member firms in relation to the ICC arbitration. The Resolution also states that it is in the interest of the SC, the AA member firms, and the Andersen Worldwide Organization to take all necessary and appropriate measures including, if appropriate, giving notice to AC member firms that they had breached their agreements with the SC and subjecting them to termination if the breaches were not cured. On February 13, 1998, the AC member firms filed this action together with an order to show cause seeking a temporary restraining order ("TRO") and a preliminary injunction to prevent the SC from taking any action to implement the Resolution. Following argument held that day, the Court denied the petitioners' request for a temporary restraining order, but set a hearing date of February 20, 1998 on the application for a preliminary injunction. Thereafter, on February 18, 1998, the petitioners filed a motion for an order compelling arbitration. Having heard argument on the pending application for a preliminary injunction and the motion to compel arbitration and having reviewed the evidence submitted by the parties, pursuant to Federal Rule of Civil Procedure 52(a) the Court makes the following Findings of Fact and reaches the following Conclusions of Law.

FN1. The Court granted Arthur Anderson LLP's oral motion to intervene which it made at the argument on the petitioners' application for a temporary restraining order. See *infra* at Findings of Fact, ¶ 12. Arthur Andersen LLP is the United States based AA business unit member firm and is one of the worldwide AA business unit member firms.

FINDINGS OF FACT:

1. The Andersen Worldwide organization provides, tax, audit, and consulting services to its clients through over 150 member firms with over 2,700 partners located around the world. The current Andersen Worldwide organizational structure was created in 1989. Although each Andersen member firm is an independent legal entity, the member firms are divided between one of two business units depending upon the services they provide to their clients. Those member firms offering tax and audit services are part of the

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Arthur Andersen business unit, and those member firms offering consulting services are part of the Andersen Consulting business unit. The Andersen Consulting business unit member firms are the petitioners in this case. Intervenor-respondent Arthur Andersen LLP is the Arthur Andersen business unit member firm located in the United States.

*2 2. Respondent Andersen Worldwide Societe Cooperative ("SC") serves as the umbrella administrative organization that coordinates the activities of the AA and AC business units and their various member firms. The SC is a cooperative company organized under Title XXIX of the Swiss Federal Code of Obligations and is domiciled in Meyrin, Switzerland. (Andersen Worldwide Societe Cooperative Articles ("Articles"), Article I.) Each member firm has a contract with the SC called a Member Firm Interfirm Agreement ("MFIA") which controls that member firm's relationship with the SC and other member firms. (Grafton Aff. ¶ 3.)

3. The governance structure of the SC is set forth in the Articles and Bylaws of the SC. (See SC Articles, Ex. A to Grafton Aff.; SC Bylaws, attached as Ex. D to Ostrager Aff.) Control of the SC is divided between the "Meeting of the partners," the "Board of Partners" (the "Board") and the Administrative Council. The "Meeting of the partners" is the general assembly of the SC partners and has various powers including the ability to elect or remove members of the Board and the Administrative Council, to elect or remove partners, and to amend the Articles and Bylaws. (Article 10.) The Board includes twenty-four partners, of whom fifteen are chosen by the AA member firms and nine are selected by the AC member firms. The chief executive of Andersen Worldwide Societe Cooperative, the managing partner of the AA business unit, and the managing partner of the AC business unit are also members of the Board. (Grafton Aff. ¶ 6.) Thus, the AA member firm partners comprise a majority of the Board. The Board may receive and act upon recommendations of the Administrative Council with respect to planning, organizational and financial issues, may recommend to the partners for their approval various actions including the election or removal of partners, and may appoint special committees. (See Article 16.) The three-member Administrative Council consists of the Chief Executive and two other individuals. The Administrative Council is the

executive body responsible for managing the affairs of the SC and is vested with the authority to decide all matters not delegated to the partners in general or to the Board. (See Articles 17-18.)

4. Article 33 of the SC Articles requires that all disputes "arising out of or in connection with" the Articles and Bylaws of the SC shall be resolved through arbitration by a single arbitrator in Geneva, Switzerland pursuant to the Rules of Conciliation and Arbitration of the International Chamber of Commerce ("ICC"). (Article 33.) The standard member firm interfirm agreement contains a similar provision requiring arbitration of all disputes "arising out of or in connection with" the member firm interfirm agreement. (Standard MFIA ¶ 22, attached as Ex. B to Ostrager Aff. ("Standard MFIA")) However, the parties in this case dispute whether each member firm is a party to a MFIA with this standard arbitration provision. The respondents contend that some MFIA's require that all disputes be arbitrated pursuant to the Swiss Intercantonal Arbitration Convention, rather than the Rules of Conciliation and Arbitration of the ICC. (See Raab Aff. In Opp'n to Order Compelling Arbitration ¶ 4.) The petitioners argue that in 1991 and 1994, all member firms ratified changes to their MFIA's adopting the ICC as the arbitral forum.

*3 5. The standard MFIA establishes procedures for termination of the agreement. If either the member firm or the SC believes that the other party has breached the MFIA, the aggrieved party "shall give notice to the other party to that effect, specifying with particularity the nature of the alleged breach or default." (Standard MFIA ¶ 14.2(F).) If the alleged breach is not cured or resolved within sixty days after the receipt of the notice of breach, the complainant may terminate the agreement so long as the notice of the termination is given within three months following the expiration of the sixty day period. (*Id.*) Moreover, the sixty day period can be extended by mutual agreement. (*Id.*)

6. On December 17, 1997, the AC member firms filed a request for arbitration in the ICC, naming the SC and all AA member firms as respondents. (See Request for Arbitration, attached as Ex. A. to Ostrager Aff. ("Request for Arbitration")) The AC member firms allege that the AA member firms have breached their material obligations to AC under the MFIA's by engaging in and developing a consulting practice that is in

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competition with AC's practice. The AC member firms further contend that the SC has breached its material obligations under the MFIA's by failing to implement the policies of cooperation and compatibility among the member firms of both business units. In the arbitration, the AC member firms seek various forms of relief, including a declaration that the AA member firms and the SC are in breach of their material obligations under the MFIA's, a declaration that the AC member firms are excused from any further obligations under their MFIA's as a result of the inequitable conduct of the AA member firms and the SC, and damages in the amount of \$400 million. In the alternative, the AC member firms seek a declaration that they are excused from any further obligations under their MFIA's because of "fundamental and irreconcilable differences" as a result of the conduct of the AA member firms and the SC. (Request for Arbitration at 49.) The AC member firms did not provide any prior notice to the SC or the AA member firms that they intended to file a request for arbitration or that they considered the SC or the AA member firms in breach of their MFIA's.

7. On February 11 and 12, 1998, the Board of Partners of the SC met in Palo Alto, California. On February 11, 1998, the SC's acting chief executive, W. Robert Grafton, cautioned the Board that, according to the SC's Swiss counsel, all elected members of the Board and the two business unit heads had a "disabling conflict of interest with the SC in that their member firms are party to the arbitration." (Grafton Aff. ¶ 9b.)

8. On February 12, 1998, the Board adopted certain "Recitals and Resolutions" (the "Resolution") proposed by Jim Wadia, the managing partner of the AA business unit and an ex officio member of the Board of Partners. The Resolution contained a series of "whereas" clauses followed by four "resolved" clauses. In the "whereas" section, the Resolution refers to the pending arbitration request and alleges that the "allegations asserted [in the arbitration] by the Claimant Member Firms to support their claim are manifestly false and misleading." The Resolution further states that the arbitration request was the product of a secret and long-developing plan by the AC member firms to avoid their obligations under the MFIA's and to injure the SC through an orchestrated publicity campaign. (See Resolution at 1-3, attached as Ex. D to Quinn Aff.)

*4 9. The Resolution contains four resolutions. First, the Board resolved that "all necessary and appropriate measures be taken ... to protect the interests of [the SC] and the Respondent Member Firms, including if appropriate under the circumstances the giving of notice to each individual Claimant Member Firm in accordance with paragraph 14 of their [MFIA's] to the effect that the Claimant Member Firms have breached such agreements, thereby entitling [the SC] and/or the Respondent Member Firms, if such breaches are not cured, to terminate the [MFIA's] of the Claimant Member Firms..." Second, the Board directed that the appropriate Board members and officers of the SC take all necessary or appropriate actions to effectuate the first "resolved" clause, and "to seek to facilitate the negotiation of a resolution acceptable to all parties of the matters in dispute between the parties." The third provision directs the appropriate Board members and officers of the SC to take such action as may be prudent to protect the SC "against any misconduct by the Claimant Member Firms ." Finally, the fourth resolution creates an "AWO Protection Committee," a special Board committee (consisting of non-AC partners) authorized "to determine the measures [the SC] should take to protect the interests of [the SC] and the Respondent Member Firms ... including any negotiations with the Claimant Member Firms, and also to review and make recommendations on all matters relating thereto to be acted upon by the Board"

10. The Resolution was approved by a majority of the Board. All 16 AA partners on the Board, including the fifteen elected partners and Wadia, the AA business unit managing partner, voted for its adoption. (Andrews Aff. ¶ 7.) However, the ten AC partners on the Board, including the nine elected partners and George Shaheen, the AC business unit managing partner, opposed the adoption of the Resolution. (Kelly Letter at 1, attached as Ex. B to Grafton Aff.) W. Robert Grafton, the acting chief executive of the SC, also opposed the Resolution. (Grafton Aff. ¶ 9c.)

11. Grafton told the Board that he opposed the Resolution based on the partners' conflict of interest and because he believed that "insofar as the resolutions authorized action by an 'AWO Protection Committee,' they exceeded the oversight authority of the Board of Partners." (Grafton Aff. ¶ 9c.) Grafton has also informed

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the SC partners that he will decline to serve on the AWO Protection Committee if asked and has stated in this litigation that he will view any advice or directives from the committee solely as a recommendation to the SC's management. (Grafton Aff. ¶ 10; Grafton Dep. at 41-42, attached as Ex. H to Ostrager Reply Aff.)

12. On February 13, 1998, the AC member firms brought by order to show cause an application for a temporary restraining order and preliminary injunction in aid of arbitration to bar the SC's Board from implementing any provision of the Resolution. After hearing argument, the Court denied the application for a TRO, finding that the petitioners had failed to show that they would suffer irreparable harm and that they had not shown a sufficient likelihood of success on the merits or that the balance of equities tipped decidedly in their favor. (February 13, 1998 Tr. at 33-34.) The Court established an accelerated briefing schedule and granted the petitioners' request for limited expedited discovery. (Tr. at 39, 43.) In addition, the Court granted Arthur Andersen LLP's application to intervene. (Tr. at 43-44.)

*5 13. On February 18, 1998, after the Order to Show Cause seeking a TRO was filed, the petitioners filed a motion to compel the arbitration of the propriety of the Resolution. However, to date, no party has refused to arbitrate that issue, although some of the AA business unit member firms have asserted that under their particular MFIA's, the ICC is not the appropriate arbitral forum for disputes concerning them. The AA business unit member firms will shortly be filing any jurisdictional objection they might have with the ICC. (Letter of James W. Quinn, Esq. dated February 24, 1998 at 2). In any event, the respondents both agree that arbitration before the ICC or in accordance with the Swiss Intercantonal Arbitration Convention is appropriate to resolve the propriety of the Resolution.

14. In further support of their application for a preliminary injunction, the AC member firms submitted an affidavit from Michael G. McGrath, the Chief Financial Officer of the AC Business Unit. McGrath alleges that without the SC the AC member firms have no legal organizational structure. (McGrath Aff. ¶ 3.) He contends that the SC handles all borrowing for the member firms and maintains financial records, payroll, and employee and health benefits. (*Id.*) McGrath

also states that AC shares computer operations, a worldwide tax structure, and training facilities with AA. Without an injunction, McGrath believes that AC must "create a complete infrastructure to support the functions the SC presently provides" so that AC can remain operational. (*Id.* at ¶ 5.) In McGrath's opinion, this infrastructure could not be completed within 60-90 days without "enormous chaos, disruption, and dislocation." In an additional affidavit submitted after argument, John T. Kelly, a partner in the AC business unit, stated that "[a]s soon as the resolution was passed, [AC] began creating the complex infrastructure needed to replace the administrative and other services provided by the SC." (Kelly Aff. ¶ 4.) This effort is very expensive to AC in terms of money and time. (Kelly Aff. ¶ 6.)

15. At a hearing held on the preliminary injunction and motion to compel arbitration, counsel for the petitioners limited the scope of preliminary injunctive relief sought from that previously requested. Instead of barring the SC from taking any action with respect to the Resolution, the petitioners now seek solely to prevent the SC from giving notices of breach or termination to any AC business unit member firms at the direction of the "AWO Protection Committee." (Ostrager Second Supplemental Reply Aff. ¶ 2.)

16. On February 22, 1998, the petitioners submitted the issues arising from the adoption of the Resolution to the arbitration pending before the ICC. (Ex. B to Ostrager Second Supplemental Reply Aff. at 1.) The petitioners have also requested that the ICC expedite the process of appointing the arbitrator. (Ex. A to Ostrager Second Supplemental Reply Aff. at 1.)

CONCLUSIONS OF LAW:

JURISDICTION:

*6 1. The petitioners' claims fall under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958 (the "Convention") and therefore are "deemed to arise under the laws and treaties of the United States." 9 U.S.C. § 203. Specifically, petitioners' belated motion to compel arbitration falls under Article II paragraph 3 of the Convention, which provides that "the court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the

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meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed." See 9 U.S.C. § 201 ("The [Convention] shall be enforced in United States courts in accordance with this chapter."); see also 9 U.S.C. § 206 ("A court having jurisdiction under this chapter may direct that arbitration be held in accordance with the agreement")

2. This Court also has subject matter jurisdiction to entertain an application for preliminary injunctive relief in aid of arbitration. See *Borden, Inc. v. Meiji Milk Products Co., Ltd.*, 919 F.2d 822, 826 (2d Cir.1990) ("We hold that entertaining an application for a preliminary injunction in aid of arbitration is consistent with the court's powers pursuant to § 206."), *cert. denied*, 500 U.S. 953, 111 S.Ct. 2259, 114 L.Ed.2d 712 (1991). [FN2]

FN2. Although the respondents argue that this Court lacks jurisdiction because the preliminary injunction in aid of arbitration was sought prior to the filing of the motion to compel, it would make no sense for the Court to dismiss the request for a preliminary injunction only for the petitioners to refile it now that the motion to compel arbitration has been filed. In any event, for the reasons stated below, the request for a preliminary injunction is denied.

THE MOTION TO COMPEL ARBITRATION:

3. The petitioners move to compel the SC to arbitrate in the pending ICC arbitration "all of the claims, allegations, and disputes concerning Petitioners' filing of their Request for Arbitration dated December 17, 1997, ... that are described in, and the subject matter of, the [Resolution] including, without limitation, all claims of wrongdoing arising out of the commencement of [the ICC Arbitration]." Notice of Motion for an Order Compelling Arbitration dated February 18, 1998, at 2. The petitioners have also filed an addendum to their ICC arbitration request in which they ask the ICC for a declaration that the petitioners' decision to file the arbitration was in accordance with their MFAs and that by passing the February 12, 1998 Resolution, the Board

violated their MFAs.

4. The respondents contend, and the petitioners agree, that a prerequisite for the issuance of an order compelling arbitration is the rejection of a demand to arbitrate by the respondents. See 9 U.S.C. § 4 ("A party aggrieved by the alleged ... refusal of another to arbitrate ... may petition any United States district court ... for an order directing that such arbitration proceed" (emphasis added)) The petitioners argue that the Resolution, with its implied threat of notice of breach, is a de facto refusal to arbitrate. The respondents respond that prior to the filing of this lawsuit, no demand for arbitration of the Resolution was made, and, in any event, both the SC and Arthur Andersen LLP have agreed to arbitrate the issues regarding the propriety of the Resolution. With respect to whether a demand for arbitration is a prerequisite to suit, in *Daye Nonferrous Metals Co. v. Trafigura Beheer B.V.*, No. 96 Civ. 9740, 1997 WL 375680, at *8-*9 (S.D.N.Y. July 7, 1997), Judge Sweet determined that under 9 U.S.C. § 206 and the Convention, "there exists no requirement that a party obtain a specific status before a court can compel arbitration ." Since 9 U.S.C. § 4 (requiring that a party requesting an order to compel arbitration be "aggrieved") and the Convention are in conflict, Judge Sweet found that the Convention governs and no demand is required. See *id.*; see also 9 U.S.C. § 208 ("Chapter 1 [[the Federal Arbitration Act] applies to actions and proceedings brought under this chapter to the extent that [Chapter 1] is not in conflict with this chapter or the Convention as ratified by the United States.") In any event, the Court need not decide in this case whether a demand to arbitrate is a prerequisite to an order compelling arbitration because other considerations require the denial of the motion to compel arbitration.

*7 5. 9 U.S.C. § 206 states that "[a] court having jurisdiction under this chapter may direct that arbitration be held in accordance with the agreement at any place therein provided for, whether that place is within or without the United States." This language is permissive and affords the Court discretion in determining whether to grant a motion to compel arbitration. See, e.g., *Filanto, S.p.A. v. Chilewich Int'l Corp.*, 789 F.Supp. 1229, 1242 (S.D.N.Y.1992) (noting permissive language of § 206), *appeal dismissed*, 984 F.2d 58 (2d Cir.1993).

6. The petitioners argue that the Court should

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compel the SC to arbitrate all issues relating to the Resolution pursuant to the arbitration provision contained in the Articles of the SC, which establishes the ICC as the arbitral forum. In response, SC contends that this motion is an attempt to circumvent the current jurisdictional dispute pending before the ICC as to which arbitral forum is appropriate given the different choices set forth in various member firm MFIA's.

7. Under the circumstances of this case, the Court declines to order that the SC arbitrate all issues relating to the Resolution before the ICC. First, there is no reason to compel the SC to arbitrate the issues relating to the Resolution because it has never refused to do so and asserts that any dispute over those issues must be submitted to arbitration.

Indeed, there is no evidence that any party has refused to arbitrate those issues. Second, the SC correctly argues that it should not be compelled by this Court to arbitrate the validity of the Resolution in the pending ICC arbitration, because, while it is prepared to litigate that issue in an ICC arbitration, the jurisdictional issue of whether the ICC arbitration is the proper forum is itself subject to resolution before the ICC. The ICC should decide whether these issues are properly litigated in the pending ICC arbitration, in another ICC arbitration, or in another forum under the Swiss Inter cantonal Arbitration Convention. The ICC has the ability to make that decision in the current proceeding where the SC and all AC and AA member firms will be represented. The SC should not be subjected to the possibility of any conflicting decisions by this Court and the ICC, particularly since all the AA member firms are not represented before this Court and because no party has disputed that these issues should be subject to arbitration. Hence, the propriety of the Resolution will be arbitrated at the appropriate time following a decision of the ICC on the jurisdictional question without this Court's intervention. The motion to compel arbitration of these issues in the pending ICC arbitration is denied.

THE APPLICATION FOR A PRELIMINARY INJUNCTION:

8. The petitioners seek a preliminary injunction in aid of arbitration to enjoin the SC from issuing notices of breach to AC member firms in conjunction with the Resolution until an arbitrator is appointed. To prevail on its motion for a preliminary injunction, the party requesting such

relief must show:

*8 (a) irreparable harm and (b) either (1) likelihood of success on the merits or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly toward the party requesting the preliminary relief.

Blum v. Schlegel, 18 F.3d 1005, 1010 (2d Cir.1994) (quoting *Jackson Dairy, Inc. v. H.P. Hood & Sons, Inc.*, 596 F.2d 70, 72 (2d Cir.1979); see also *Roso-Lino Beverage Distributors, Inc. v. Coca-Cola Bottling Co. of New York, Inc.*, 749 F.2d 124, 125-126 (2d Cir.1984); *Istar-Tass Russian News Agency v. Russian Kurier, Inc.*, 886 F.Supp. 1120, 1123 (S.D.N.Y.1995); *Alvenus Shipping Co., Ltd. v. Delta Petroleum (U.S.A.) Ltd.*, 876 F.Supp. 482, 487 (S.D.N.Y.1994) (granting preliminary injunction in aid of arbitration pursuant to *Borden*); *Circus Prods., Inc. v. Rosgoscirc*, No. 93 Civ. 1304, 1993 WL 403993, at *2 (S.D.N.Y. Oct.5, 1993); *Litho Prestige, Div. of Unimedia Group, Inc. v. New Am. Publishing, Inc.*, 652 F.Supp. 804, 807 (S.D.N.Y.1986).

9. "[A] showing of probable irreparable harm is the single most important prerequisite for the issuance of a preliminary injunction." *Reuters Ltd. v. United Press Int'l, Inc.*, 903 F.2d 904, 907 (2d Cir.1990) (citations and internal quotation marks omitted). The plaintiff must establish "an injury that is neither remote nor speculative, but actual and imminent." *Tucker Anthony Realty Corp. v. Schlesinger*, 888 F.2d 969, 975 (2d Cir.1989) (quoting *Consolidated Brands, Inc. v. Mondy*, 638 F.Supp. 152, 155 (E.D.N.Y.1986).

10. The petitioners argue that the mere threat of notice of breach, despite the required sixty day cure period, forces them to create an entirely new legal, financial, and administrative structure to replace the SC since, should such notices be issued, sixty days will not provide enough time to complete this task. The purpose of this threat, the petitioners argue, is to prevent them from exercising their contractual rights under the MFIA's to pursue resolution of their grievances with the SC and the AA business unit member firms through arbitration.

11. The petitioners' attempt to show irreparable harm fails for several reasons. First, as the petitioners concede, the MFIA's explicitly provide for a sixty day "cure" period following the issuance of a notice of breach before which a member firm may be terminated. No notice of

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breach has been issued to any of the AC member firms, nor did the Resolution itself constitute such notice. (Wadia Mem., attached as Ex. J. to Quinn Aff.) Wadia testified at his deposition that the AWO Protection Committee which had been established by the Resolution had yet to meet, that no committee chair had been selected, and that no schedule of meetings had been established. (Wadia Dep. at 34-35, attached as Ex. B to Ostrager Supplemental Reply Aff.) Further, even if the AWO Protection Committee is constituted, conducts an investigation, and directs the issuance of notices of breach, Grafton has declared his intent to treat any such directive as a recommendation. (Grafton Dep. at 41-42, attached as Ex. H to Ostrager Reply Aff.) Thus, at this stage, the issuance of notices of breach to any AC member firms is at best speculative and certainly cannot be characterized as imminent. If the AWO Protection Committee ever convenes and recommends notices of breach, and if the SC takes any action on those recommendations, then those AC member firms to whom such notices are sent will still have the opportunity to seek relief, most appropriately in an arbitral forum where all parties have agreed to air their disputes.

*9 12. Second, all parties agree that the questions as to whether the Resolution was a proper exercise of the Board's power and whether any future issuance of a notice of breach is proper can and should be decided through arbitration pursuant to the Articles of the SC and the MFAs governing the parties' relationship. The respondents have not refused to arbitrate, although some AA member firms have questioned which arbitral forum is appropriate based on individual MFAs. Thus, there can be no irreparable harm here requiring an injunction in aid of arbitration when the propriety of all alleged obstacles created by the respondents to prevent the arbitration are themselves arbitrable. Indeed, injunctive relief is available in an ICC arbitration.

13. Finally, the petitioners cannot show that they will suffer irreparable harm should notices of breach be issued by the AWO Protection Committee. Although the petitioners contend that it was only after the Resolution was passed that they began to create the infrastructure needed to survive without the SC, those claims are not persuasive. The indisputable fact is that the petitioners initiated what they realized could be as short as a six-month arbitration process in December 1997 with the intention of severing

their relationship with the SC and the AA member firms. The petitioners understood at that time that they would have to set up their own administrative structure if they separated themselves from Andersen Worldwide, and they were obviously prepared to do that. Indeed, there is evidence that the AC member firms had been creating their own independent structure prior to December 1997. (See Eibl Aff. ¶¶ 3-7.) The petitioners certainly understood the ramifications of their December 1997 request to be excused from their obligations under their MFAs. Nor is it significant that the petitioners believed the arbitrator would have set a lengthy schedule for accomplishing a severance, since there is no guarantee that the arbitrator would have agreed with the petitioners on this point. Thus, it makes no sense to consider the mere threat of termination irreparable harm. The petitioners are complaining about the threat of the very result that they expressly desire in the arbitration and which they have sought to bring about.

14. In addition to failing to show imminent irreparable harm, the petitioners cannot show either a likelihood of success on the merits or sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly in their favor. With respect to the required showing of a likelihood of success on the merits, the petitioners cannot show that the Resolution interferes with their ability to arbitrate their claims against the SC and the AA member firms before the ICC or elsewhere. Initially, regardless of the intent of the Board in passing the Resolution, the Resolution simply cannot attempt to decide the issues pending before the arbitrator as the petitioners claim since the arbitrator is free to disregard the Resolution, and, now that the petitioners have requested that the issue of the Resolution be arbitrated, and the respondents have agreed that the issue is subject to arbitration, the propriety of the Resolution will itself be resolved by arbitration. It makes no sense to say that the Resolution has interfered with the ICC arbitration when the propriety of the Resolution will in fact be arbitrated. Further, the petitioners have not shown any likelihood of demonstrating that the creation of the AWO Protection Committee has interfered with their pursuit of the ICC arbitration. Wadia testified at his deposition that the AWO Protection Committee would take

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no action to determine the position of the SC in the arbitration. (Wadia Dep. at 72, attached as Ex. B to Ostrager Supplemental Reply Aff.) Finally, as discussed above, no action has been taken in furtherance of the purported threat of the Board to issue notices of breach and it is apparent from the papers that the petitioners have in no sense been "chilled" from exercising their right to arbitration. Thus, the petitioners have failed to show any likelihood of success on their contention in this litigation that the Resolution prevents them from arbitrating their claims, nor have they shown sufficiently serious questions going to the merits of their claims to make them a fair ground for litigation.

*10 15. Finally, the petitioners have not shown a balance of hardships tipping decidedly in their favor. While the petitioners claim that the very threat of notices of breach causes substantial harm to the member firms, the AC member firms have themselves demanded that the SC send notices of breach to all of the AA member firms, and have warned the SC that the failure of the SC to comply with that demand would be a breach of the SC's ethical, fiduciary and contractual duties to the AC member firms. (Kelly letter, attached as Ex. B to Grafton Aff.) Rather than relying on arbitration, the petitioners have engaged in extra-arbitral self-help, despite their claim that such threats themselves cause serious harm. It cannot be said that the balance of hardships in this internal struggle--which should be resolved peaceably in arbitration--tips decidedly in favor of the petitioners.

CONCLUSION

For the foregoing reasons, the petitioners' motion to compel arbitration is denied, and the petitioners' request for a preliminary injunction in aid of arbitration is also denied.

SO ORDERED.

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H

United States District Court,
S.D. New York.

In re WORLDCOM, INC. Securities Litigation

No. 02 Civ. 3288(DLC).

June 25, 2003.

Investors in communications corporation sued auditor, individual partners of auditor, and affiliates, alleging that approval of fraudulent financial statements was securities fraud in violation of § 10(b). Defendants moved to dismiss. The District Court, Cote, J., held that: (1) investors satisfied scienter requirement for suit against auditor; (2) investors failed to state claim against partners; and (3) investors failed to state claim against affiliates.

Motion granted in part, denied in part.

West Headnotes

[1] Securities Regulation ¶60.45(3)
349Bk60.45(3) Most Cited Cases
Brokers.

Investors satisfied scienter requirement, for stating § 10(b) securities fraud claim against auditor of communications corporation found to have falsified financial statements by taking excessive charges to income in connection with acquisitions, and in avoiding recognition of expenses of unused communications lines, by alleging that auditors were reckless for failing to conduct document inspection that would have revealed fraud. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j, 78u-4(b)(2).

[2] Securities Regulation ¶60.40
349Bk60.40 Most Cited Cases

Investors failed to state § 10(b) securities fraud claim against individually named partners of auditing firm, for approving communication corporation's fraudulent financial statements containing excessive expense recognition of mergers and avoidance of recognition of line

expenses; there was no attribution of any representation to partners or showing of scienter on their part. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j, 78u-4(b)(2).

[3] Securities Regulation ¶60.40
349Bk60.40 Most Cited Cases

Investors failed to state claim of § 10(b) liability against European affiliate of auditing firm, for approval of fraudulent financial statements of communications corporation; there was no showing of affiliate's involvement in statements, and firm did not act as affiliate's agent in committing any fraud. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j.

Max W. Berger, John P. Coffey, Bernstein Litowitz Berger & Grossmann LLP, New York, NY, Leonard Barrack, Gerald J. Rodos, Jeffrey W. Golan, Barrack Rodos Bacine, Philadelphia, PA, for Lead Plaintiff in the Securities Litigation.

Eliot Lauer, James R. Banko, Curtis Mallot Prevost Colt & Mosley, New York, NY, for Defendants Arthur Andersen LLP & Melvin Dick.

Eliot Lauer, Michael Moscato, Michael Hanin, Curtis Mallot Prevost Colt & Mosley, New York, NY, for Defendant Mark Schoppet.

William R. Maguire, Derek J.T. Adler, Sarah K. Loomis, Hughes Hubbard & Reed LLP, New York, NY, for Defendant Andersen UK.

James J. Sabella, Sidley Austin Brown & Wood LLP, New York, NY, William F. Lloyd, Jeffrey R. Tone, David A. Gordon, Sidley Austin Brown & Wood LLP, Chicago, IL, for Defendant Andersen Worldwide Societe Cooperative.

OPINION AND ORDER

COTE, J.

*1 This Document Relates to: ALL ACTIONS

In the summer of 2002, WorldCom, Inc. ("WorldCom") disclosed that it had improperly reported and would have to restate its publicly-reported financial results from 1999 through the first quarter of 2002. Plaintiffs in this

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litigation contend that defendants associated with WorldCom violated provisions of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") by publishing false information about WorldCom's financial condition in analyst reports, press releases, public statements, and filings with the Securities and Exchange Commission ("SEC").

Arthur Andersen LLP, who was WorldCom's outside accountant, two Andersen partners, Arthur Andersen's affiliate in Great Britain, and the Swiss umbrella organization for all Andersen firms, are alleged to have committed securities fraud in connection with publicly-disseminated audit opinions that materially misrepresented WorldCom's financial state. Each of the Andersen defendants is alleged to have violated Section 10(b) of the Exchange Act. In addition, Arthur Andersen LLP is alleged to have violated Section 11 of the Securities Act. This Opinion addresses the Andersen defendants' motions to dismiss the consolidated class action complaint filed in the multi-district securities litigation ("Complaint").

The descriptions that follow summarize the allegations in the Complaint relevant to the motions to dismiss addressed in this Opinion. In addition to the allegations addressed in this Opinion, the Complaint pleads claims against WorldCom officers, directors, underwriters, the outside analyst Jack Grubman, Solomon Smith Barney, and Citigroup, Inc. The allegations pertaining to those defendants and their motions to dismiss were addressed in a recent Opinion. *See In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288(DLC), 2003 WL 21219049 (S.D.N.Y. May 19, 2003) ("May 19 Opinion"). Familiarity with the May 19 Opinion is assumed. [FN1]

FN1. Portions of this Opinion draw heavily from the May 19 Opinion, including the Complaint's description of the accounting fraud at WorldCom, the law regarding pleading standards generally and in particular for the alleged securities fraud claim. A description of the procedural history of this litigation is included in the May 19 Opinion. *See In re WorldCom, Inc. Sec. Litig.*, 2003 WL 21219049, at *1.

I. Background

A. Parties

Plaintiffs

New York State Common Retirement Fund ("NYSCRF"), the lead plaintiff, 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 and is the second largest public pension fund in the United States. Three entities have joined the action as named plaintiffs: the Fresno County Employees Retirement Association ("FCERA"), the County of Fresno, California ("Fresno"), and HGK Asset Management ("HGK"), a registered investment advisor.

Defendants

Arthur Andersen LLP

Arthur Andersen LLP ("Andersen") was once one of the "Big 5" firms of certified public accountants. During the class period, Andersen provided accounting services for WorldCom, audited WorldCom's year-end financial statements, and reviewed its quarterly statements. Andersen issued unqualified audit reports regarding WorldCom's financial statements for inclusion in (1) WorldCom's Form 10-K annual reports for each year from 1999 through 2001; (2) the registration statements for WorldCom acquisitions between 1999 and 2002; and (3) the registration statements filed in connection with WorldCom's massive 2000 and 2001 bond offerings. Andersen's statements contained in each of the Forms 10-K from 1999 through 2001 falsely represented that Andersen had conducted its audits in accordance with generally accepted accounting standards ("GAAS") and that WorldCom's financial statements were in conformity with generally accepted accounting principles ("GAAP") and as such were materially misleading. Andersen also performed reviews of the WorldCom quarterly statements issued with respect to the first three quarters of each year from 1999 through 2001 and the first quarter of 2002. In May 2002, WorldCom replaced Andersen with KPMG LLP.

Mark Schoppet

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*2 Mark Schoppet ("Schoppet"), a certified public accountant, was the senior partner at Andersen with responsibility for audits of WorldCom financial statements. Schoppet was the engagement partner for Andersen's audits of WorldCom financial statements up to and including 2000.

Melvin Dick

Melvin Dick ("Dick"), a certified public accountant, was also a senior partner at Andersen with responsibility for the audits of WorldCom financial statements. Dick was the engagement partner for Andersen's audit of WorldCom's financial statements for 2001. Dick testified before Congress that neither he nor any member of the Andersen audit team had any idea prior to June 2002 that WorldCom (as explained below) had fraudulently transferred "line costs."

Arthur Andersen (United Kingdom)

Arthur Andersen ("Andersen UK"), a British public accounting firm, is a member of Andersen Worldwide SC. During the class period, Andersen UK audited WorldCom financial statements with Andersen.

Andersen Worldwide SC

Andersen Worldwide SC ("AWSC") is a Swiss Societe Cooperative and serves as an "umbrella organization" for its member firms throughout the world. Andersen and Andersen UK are member firms of AWSC. "Through Andersen and Andersen UK," AWSC was "involved" in WorldCom audits.

B. Accounting Irregularities

WorldCom manipulated its books in two main areas: (1) its charges to income and classification of assets in connection with acquisitions, and (2) its accounting for "line" costs. In each of these areas, WorldCom failed to follow GAAP, and instead freely reworked its numbers in order to meet marketplace earnings projections.

I. Acquisitions

Part of the acquisition process involves identifying costs incurred in connection with each merger and taking corresponding charges to income.

WorldCom improperly recorded expenses at the time of the acquisition that should not have been included. The effect was to inflate earnings in later periods when the expenses were actually incurred and should have been recorded.

In addition, at the time of acquisitions, WorldCom took overly large and unjustified charges to income, creating inflated merger reserves that it would later tap into when it needed to do so to boost reported earnings. Enormous charges were typical of the mergers and acquisitions in the 1990s and "WorldCom and its senior officers knew that Wall Street would not be concerned with the size of the charges."

WorldCom used the acquisition of MCI in September 1998 in particular to manipulate its earnings statements by improperly classifying the assets it obtained. WorldCom understated the book value of MCI's property, plant and equipment assets and overstated the value of the goodwill acquired. By classifying MCI's value in terms of a slowly depreciating asset like goodwill rather than hard assets, which depreciate in one-tenth of the time, WorldCom improperly inflated its earnings during the years immediately following the MCI acquisition.

2. Line Costs

*3 With a decline in its revenue, and further prompted by the failure in early 2000 of its attempt to acquire Sprint, WorldCom began a new accounting fraud in connection with its single largest operating expense: line costs. WorldCom had entered into long-term lease agreements with other telecommunications companies for the use of their networks. Pursuant to these leases, WorldCom was obligated to make fixed monthly payments for the use of the networks, or lines, regardless of whether WorldCom or its customers in fact used the leased lines. When demand did not grow as WorldCom had hoped, the company found itself with substantial fixed line costs for networks that were not generating any income.

Under GAAP, line costs must be reported as an expense. In October 2000, and without any justification in fact or under GAAP, Scott D. Sullivan ("Sullivan"), WorldCom's Chief Financial Officer, instructed Buford Yates, Jr., WorldCom's

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Director of General Accounting, David F. Myers ("Myers"), WorldCom's Controller and a Senior Vice President, and others in WorldCom's accounting department to make journal entries crediting WorldCom's line cost expense accounts, and instructed Myers and others to make corresponding reductions in various reserve accounts so that the general ledger would balance.

In 2001, WorldCom changed its method for disguising the impact of line costs on its revenues. Sullivan directed that line costs simply be reclassified as capital expenditures that could be depreciated over time. The effect of the reclassification was to inflate WorldCom's reported earnings.

3. Discovery of the Accounting Fraud

In May 2002, WorldCom's Vice President of Internal Audit initiated an investigation of WorldCom's capital expenditures and capital accounts. Within a month, the investigation determined that WorldCom had made large, dubious transfers with respect to line costs. By mid-June, the internal audit team had determined that there was no documentary or other support for the transfers. Those responsible for the accounting entries admitted to the internal audit team that they had no documents to support the treatment of line costs.

On June 25, 2002, WorldCom announced that it had improperly treated more than \$3.8 billion in ordinary costs as capital expenditures in violation of GAAP and would have to restate its publicly-reported financial results for 2001 and the first quarter of 2002. WorldCom later announced that its reported earnings for 1999 through the first quarter of 2002 had been affected by manipulation of various reserves and had overstated earnings by \$3.3 billion. WorldCom also announced that it would likely write off goodwill of \$50 billion. The impact of those disclosures on the price of WorldCom shares and the value of its notes was catastrophic.

C. The Audits

As WorldCom's auditor, Andersen had unlimited access to WorldCom's books and records. Independent auditors are charged with obtaining

and evaluating evidence concerning the assertions made in their client's financial statements. Auditors are not entitled to allow representations from a company's management to substitute for the auditing procedures that are necessary to provide a reasonable basis for forming an opinion regarding the financial statements that are the subject of the audit. In auditing the financial statements, an auditor may consider as evidence all 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. The underlying accounting data should be considered when forming an opinion as to the financial statements.

*4 Professional auditors are required to act diligently and in good faith, and to apply a professional skepticism to their evaluation of evidence. An auditor should conduct the audit objectively, thoroughly and carefully. Before certifying financial statements, an auditor should have an understanding of the factors that may have a significant effect on the financial statements.

Andersen did not obtain direct evidence regarding WorldCom's treatment of merger reserves or its treatment of line costs. Instead, it relied on management's representations. Had Andersen sought supporting documentation for various adjustments and journal entries or reviewed WorldCom's general ledgers, it would have discovered that WorldCom had no documentation to support many significant adjustments or the results reported in its financial statements.

Andersen failed to obtain sufficient knowledge of WorldCom's accounting systems to understand the significance of the adjustments through which the fraud was effected. Andersen did not adequately investigate the nature and use of WorldCom's merger reserves, WorldCom's internal controls or lack thereof, or the propriety and consistency of WorldCom's application of accounting principles. If Andersen had performed a sufficient review, and sought the necessary supporting documentation, it would, or should have, discovered the on-going fraud. Instead, Andersen failed to recognize the warning signs of fraud, and to consider the obvious risk that WorldCom would engage in fraud to meet its aggressive financial targets and to protect the

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personal fortune of its CEO.

At one point, Andersen was even notified that WorldCom had made entries after the books had closed. In March 2000, Steven Brabbs ("Brabbs"), WorldCom's Director for International Finance & Control, noticed that a journal entry reducing line cost expenses by \$33.6 million had been made after the International Division had closed its books and reported its results for the first quarter of 2000. Brabbs eventually was told that the entry had been made at Sullivan's direction, but was not given any support or explanation for the entry. In April 2000, Brabbs reviewed the International Division's first quarter results with Andersen's "audit partner in the United Kingdom." Brabbs asked the auditors at Andersen UK to ask auditors in the United States to ensure that appropriate accounting was being used at the global consolidated level. Andersen UK's report on the matter was sent to Andersen and to WorldCom executives.

When Sullivan insisted that the entry be made, Brabbs established a fictitious entity and placed the entry on its books. This kept the books of the International Division "clean," but allowed WorldCom management to maintain its reported figures. The entry was labeled "late adj[ustment] as instructed by Scott Sullivan."

Andersen was well paid for its WorldCom work. WorldCom was the most valuable client for Andersen's branch office in Jackson, Mississippi. During 2001, for example, WorldCom paid Andersen \$16.8 million.

II. Legal Standards

Federal Rules of Civil Procedure

*5 The defendants move to dismiss the Complaint pursuant to Rules 9(b) and 12(b)(6), Fed.R.Civ.P., and the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. § 78u4-b.

Rule 12(b)(6)

To dismiss an action pursuant to Rule 12(b)(6), a court must determine that "it appears beyond doubt, even when the complaint is liberally construed, that the plaintiff can prove no set of facts which would entitle him to relief." *Jaghory v. New York State*

Dep't of Educ., 131 F.3d 326, 329 (2d Cir.1997) (citation omitted). In construing the complaint, the court must "accept all factual allegations in the complaint as true and draw inferences from those allegations in the light most favorable to the plaintiff." *Id.* "Given the Federal Rules' simplified standard for pleading, a court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506, 514, 122 S.Ct. 992, 152 L.Ed.2d 1 (2002) (citation omitted).

Although the court's focus should be on the pleadings, it may also consider

any written instrument attached to [the complaint] as an exhibit or any statements or documents incorporated in it by reference, as well as public disclosure documents required by law to be, and that have been, filed with the SEC, and documents that the plaintiffs either possessed or knew about and upon which they relied in bringing the suit.

Rothman v. Gregor, 220 F.3d 81, 88 (2d Cir.2000) (citation omitted); *Cortec Indus., Inc. v. Sum Holding L.P.*, 949 F.2d 42, 47-48 (2d Cir.1991). The court need not credit general conclusory allegations that "are belied by more specific allegations of the complaint." *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1092 (2d Cir.1995), and may not rely on factual allegations contained only in legal briefs. *Friedl v. City of New York*, 210 F.3d 79, 83 (2d Cir.2000).

Rule 9(b)

Rule 9(b) requires allegations of fraud, including securities fraud, to be stated with particularity. *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 168 (2d Cir.2000). Under Rule 9(b), "[m]alice, intent, knowledge and other conditions of mind of a person may be averred generally." Rule 9(b), Fed.R.Civ.P.; *Kalnit v. Eichler*, 264 F.3d 131, 138 (2d Cir.2001). To comply with the requirements of Rule 9(b), an allegation of fraud must specify: "(1) those statements the plaintiff thinks were fraudulent, (2) the speaker, (3) where and when they were made, and (4) why plaintiff believes the statements fraudulent." *Koehler v. Bank of Bermuda (New York) Ltd.*, 209 F.3d 130, 136 (2d Cir.2000).

Section 10(b) and Rule 10b-5

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To state a cause of action under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, a plaintiff must allege that "the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused injury to the plaintiff." *Lawrence v. Cohn*, 325 F.3d 141, 147 (2d Cir.2003) (quoting *Ganino*, 228 F.3d at 161); see also *Kalnit*, 264 F.3d at 138. Section 10(b) claims sound in fraud, and must satisfy the pleading requirements of Rule 9(b) and the PSLRA. See *In re Scholastic Corp.*, 252 F.3d 63, 69-70 (2d Cir.2001). "Any person or entity, including [an] accountant ... who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met." *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994) (emphasis in original).

1. Scienter

*6 "The requisite state of mind, or scienter, in an action under section 10(b) and Rule 10b-5, that the plaintiff must allege is an intent to deceive, manipulate or defraud." *Kalnit*, 264 F.3d at 138 (citation omitted). In the Second Circuit, plaintiffs alleging securities fraud have long been required to state with particularity "facts that give rise to a strong inference of fraudulent intent." *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 52 (2d Cir.1995); see also *San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 812 (2d Cir.1996).

When Congress passed the PSLRA it required that [i]n private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. 15 U.S.C. § 78u-4(b)(2) (emphasis supplied). The PSLRA raised the nationwide pleading standard for securities fraud but did not alter the level of

pleading previously required by the Second Circuit. *Kalnit*, 264 F.3d at 138; *Ganino*, 228 F.3d at 170; *Novak v. Kasaks*, 216 F.3d 300, 310 (2d Cir.2000).

"The requisite 'strong inference' of fraud may be established either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Acito*, 47 F.3d at 52 (citation omitted); see also *Kalnit*, 264 F.3d at 138; *Rothman*, 220 F.3d at 90. The Second Circuit has identified four types of allegations that may support a strong inference of scienter:

[W]here the complaint sufficiently alleges that the defendants: (1) benefitted in a concrete and personal way from the purported fraud; (2) engaged in deliberately illegal behavior; (3) knew facts or had access to information suggesting that their public statements were not accurate; or (4) failed to check information they had a duty to monitor.

Novak, 216 F.3d at 311 (citation omitted).

(a) Motive and opportunity

"Motive would entail concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged. Opportunity would entail the means and likely prospect of achieving concrete benefits by the means alleged." *Novak*, 216 F.3d at 307 (citation omitted).

(b) Conscious misbehavior or recklessness

The pleading standard also will be satisfied if plaintiffs allege facts showing that the defendant's conduct was "highly unreasonable, representing an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Rothman*, 220 F.3d at 90 (citation omitted); *Kalnit*, 264 F.3d at 142. Pleadings have been found sufficient when they have "specifically alleged defendants' knowledge of facts or access to information contradicting their public statements. Under such circumstances, defendants knew or, more importantly, should have known that they were misrepresenting material facts related to the corporation." *Kalnit*, 264 F.3d at 142 (citation omitted). If plaintiffs rely on allegations that the defendants had access to facts contradicting

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their public statements, plaintiffs must "specifically identify the reports or statements containing this information." *Novak*, 216 F.3d at 309 (citation omitted). Allegations of recklessness have also been sufficient where the allegations demonstrate that defendants "failed to review or check information that they had a duty to monitor, or ignored obvious signs of fraud." *Id.* at 308. A violation of GAAP, however, standing alone, is insufficient. *Id.* at 309.

2. Causation

*7 Another element of a Section 10(b) claim is that "plaintiff's reliance on defendant's action caused plaintiff injury." *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 534 (2d Cir.1999) (citation omitted). "It is settled that causation under federal securities laws is two-pronged: a plaintiff must allege both transaction causation, *i.e.* that *but for* the fraudulent statement or omission, the plaintiff would not have entered into the transaction; and loss causation, *i.e.*, that the subject of the fraudulent statement or omission was the cause of the actual loss suffered." *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 95 (2d Cir.2001). To show reliance on a defendant's statement, "the misrepresentation must be attributed" to the defendant at the time of public dissemination and "in advance of the investment decision." *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (1998).

III. Discussion

Andersen [FN2]

FN2. Andersen also moves to dismiss the Section 11 claim against it. In moving, it relies wholly on the arguments made by the underwriter defendants in their motion to dismiss. The motions to dismiss the Section 11 claims were denied in the May 19 Opinion. *In re WorldCom, Inc. Sec. Litig.*, 2003 WL 21219049, at *25-27. For the reasons stated therein, Andersen's motion to dismiss the Section 11 claim is denied.

[1] Taken as a whole, the allegations against Andersen adequately plead scienter. The Complaint alleges that Andersen had unlimited access to

WorldCom's books and records and had, as WorldCom's independent auditor, an obligation to review and evaluate those records in order to form an opinion regarding WorldCom's financial statements. The Complaint alleges that WorldCom's books and records contained no support for or documentation of the accounting treatment of significant merger reserves and line costs. Had Andersen reviewed WorldCom's accounting systems and data, as it was obligated to do, it would have discovered the lack of documentation and the fraudulent accounting treatment.

The allegations identifying the steps Andersen should have taken and failed to take, and the fraud it would have discovered if it had taken those steps, create a strong inference that Andersen acted recklessly in conducting the WorldCom audits. See *Novak*, 216 F.3d at 308 (allegations that defendants "failed to review or check information that they had a duty to monitor, or ignored obvious signs of fraud" are sufficient to allege recklessness). Although the size of the fraud alone does not create an inference of scienter, the enormous amounts at stake coupled with the detailed allegations regarding the nature and extent of WorldCom's fraudulent accounting and Andersen's failure to conduct a thorough and objective audit create a strong inference that Andersen was reckless in not knowing that its audit opinions materially misrepresented WorldCom's financial state. See *In re Scholastic Corp.*, 252 F.3d at 73 (size of post-class period special charge supports inference of knowledge); *Rothman*, 220 F.3d at 92 (size of write-off supports claim of fraudulent intent).

In moving to dismiss, Andersen emphasizes that the guilty plea allocutions of certain former WorldCom executives, the Indictment filed by the United States Attorney in this District against Sullivan, and the SEC's complaint against former WorldCom officers all assert that WorldCom's senior management had lied to WorldCom's auditors and concealed the falsification of the WorldCom books from the auditors. The issue presented by this motion is whether the Complaint states a claim against Andersen. It does. It alleges with sufficient particularity that Andersen would have uncovered the fraud perpetrated by WorldCom's management if it had conducted the review it was required to do before issuing its audit opinions in connection with the WorldCom annual

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financial statements, and that the Andersen audit opinions included in WorldCom's year-end financial statements materially misrepresented WorldCom's financial state.

Dick & Schoppet

*8 [2] The allegations in the Complaint are insufficient to state a Section 10(b) claim against either Schoppet or Dick. First, the Complaint fails to allege that Schoppet or Dick made a misstatement or omission on which plaintiffs relied. A defendant is not liable under Section 10(b) "for a statement not attributed to that actor at the time of its dissemination." *Wright*, 152 F.3d at 175. The Complaint alleges only that Andersen authored statements, not that any of the statements were attributed to the individual Andersen partners.

Plaintiffs' reliance on *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450 (2d Cir.1996), for the proposition that those who participate in a fraud may be liable is misplaced. As explained in *Wright*, *First Jersey* was an SEC enforcement action, brought under a provision of the securities laws that allows liability to attach to those who knowingly provide "substantial assistance" to a violator. *Wright*, 152 F.3d at 176 (citation omitted). Congress, however, has not created a private right of action under that provision. *Id.* The Second Circuit has explicitly declined to adopt a "substantial participation" test for liability for misrepresentations under Section 10(b). *Id.*

Second, the Complaint does not sufficiently allege scienter against either Schoppet or Dick. [FN3] The lengthy and detailed allegations regarding Andersen's conduct of the WorldCom audits and knowledge or recklessness with regard to the fraud are all pleaded only against Andersen itself: none of the paragraphs setting out specific details even mentions Schoppet or Dick. [FN4] At most, the Complaint implies that because Andersen either knew of the fraud or was reckless in not knowing, the engagement partners must also have known or been reckless. The Section 10(b) claim against these individual defendants is dismissed.

FN3. The additional facts in the plaintiffs' memorandum of law regarding Dick's review of workpapers and Schoppet's role

in the audits may not be used to cure this defect. *See Friedl*, 210 F.3d at 83.

FN4. In their memorandum in opposition to this motion, plaintiffs direct attention to paragraphs 432, 433 and 434 for allegations sufficient to plead scienter with respect to Schoppet and Dick. None of these paragraphs even mentions either of the defendants by name. The Complaint contains no allegations of motive or knowledge that are specific to either Schoppet or Dick.

Andersen UK

[3] Plaintiffs' limited allegations against Andersen UK are insufficient to state a claim for violation of Section 10(b). There are no allegations identifying any work performed by Andersen UK that resulted in any false statement. There are also no allegations that Andersen UK ever failed to do work, which if performed, would have unmasked the fraud. There are no allegations that Andersen UK ever made any statement on which plaintiffs relied.

The only allegation that even remotely connects Andersen UK to WorldCom's securities fraud is the allegation that Brabbs asked Andersen UK to ask Andersen to make sure that "appropriate accounting treatment was in place at the global consolidated level" because an improper journal entry had been "made by persons in the U.S. at the consolidated level." The relevant portion of the 2002 Brabbs e-mail recounting the conversation with Andersen UK from two years earlier reads as follows: [FN5]

FN5. The Brabbs e-mail may be considered in deciding defendants' motion to dismiss because it was incorporated into the Complaint by reference and was relied upon by plaintiffs. *Rothman*, 220 F.3d at 88

During April 2000, I reviewed at a high level the International Q1 results with the UK audit partner and senior manager. The increase in our margin trend due to the above entry was obvious and I explained that this was an entry made in the US,

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and that the auditors should request follow through in the U.S. to ensure appropriate accounting treatment was in place at the global consolidated level. A relevant paragraph was included in their report that was sent to both Andersens [sic] and senior WorldCom finance management in the US.

*9 The e-mail further reflects that the entry Brabbs questioned had been made by people at WorldCom in the United States after the European and Asian entities had closed their books and reported their quarterly figures to the United States.

Even viewed in the light most favorable to the plaintiffs, the Brabbs e-mail does not support their argument that Andersen UK knew or should have known of the securities fraud from either its conversation with Brabbs or its audit of any international WorldCom branch. Instead, the e-mail suggests that adjustments to the books were being made in the United States, after the foreign entities' books had closed and quarterly results had been posted. The Complaint alleges that Andersen failed to investigate WorldCom's accounting practices after Brabbs notified it of his concerns; it does not, however, allege that Andersen UK failed to do as Brabbs requested, that is, request that Andersen confirm that appropriate accounting treatment was being given to the consolidated financials. [FN6]

FN6. In their brief, plaintiffs also argue that Andersen UK's "failure to investigate" creates a strong inference of fraudulent intent. The Complaint itself, however, is silent with respect to Andersen UK's investigation. Plaintiffs refer to paragraph 317 of the Complaint as alleging that Andersen UK abdicated its responsibility to investigate: that paragraph, and the related allegations, allege only that Andersen, not Andersen UK, failed to investigate. Plaintiffs' argument cannot cure the pleading defects. See *Friedl*, 210 F.3d at 83 (2d Cir.2000).

Apart from the Brabbs e-mail, the Complaint does not identify any "red flags" that Andersen UK should have or would have encountered in its audits of WorldCom's Asian and European entities, or plead any other indicia of recklessness. It does not

even identify the WorldCom entities that were audited by Andersen UK. [FN7] In sum, in addition to the other deficiencies in its pleading of a Section 10(b) claim against Andersen UK, the Complaint contains insufficient allegations to give rise to an inference—much less a *strong* inference—that Andersen UK acted with fraudulent intent. [FN8]

FN7. WorldCom's public filings reflect that it had over 160 subsidiaries in more than fifty countries.

FN8. Because the Section 10(b) claim is dismissed, Andersen UK's arguments regarding personal jurisdiction are not addressed.

AWSC

The Complaint contains no allegations that AWSC was the source of or an identified speaker with respect to any of the misrepresentations described in the Complaint, and contains no allegations of AWSC's scienter. Instead, plaintiffs contend that AWSC is responsible for Andersen's statements and omissions and that Andersen's knowledge is attributable to AWSC under the law governing partnerships and general principles of agency law.

In 1994, the Supreme Court held that there was no private cause of action under Section 10(b) for aiding and abetting liability. *Central Bank*, 511 U.S. at 177. It did not, however, eliminate the use of principles of agency law to hold principals responsible for the misrepresentations of their agents. See *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 100-01 (2d Cir.2001); *Cromer Fin. Ltd. v. Berger*, Nos. 00 Civ. 2284 & 00 Civ. 2498 (DLC), 2002 WL 826847, at *7 (S.D.N.Y. May 2, 2002). As the Second Circuit noted in *Suez Equity*, "[a] corporation can only act through its employees and agents." *Suez Equity*, 250 F.3d at 101. Under agency law, "[t]he principal is held liable not because it committed some wrongdoing outside the purview of the statute which assisted the wrongdoing prohibited by the statute, but because its *status* merits responsibility for the tortious actions of its agent." *American Tel. & Tel. Co. v. Winback & Conserve Program, Inc.*,

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42 F.3d 1421, 1431 (3d Cir.1994); *see also Cromer*, 2002 WL 826847, at *7-8; *Vento & Co. LLC v. Metromedia Fiber Network, Inc.*, No. 97 Civ. 7751(JGK), 1999 WL 147732, at *12 (S.D.N.Y. Mar.18, 1999); *Pollack v. Laidlaw Holdings, Inc.*, No. 90 Civ. 5788(DLC), 1995 WL 261518, at *17 (S.D.N.Y. May 3, 1995); *In re Rickel & Assoc., Inc.*, 272 B.R. 74, 94 & n. 13 (S.D.N.Y.2002).

*10 While an agency theory may be used to assert liability for a Section 10(b) claim, the Complaint does not allege that Andersen was an agent of AWSC or that AWSC and Andersen are partners. It alleges only that AWSC is a Swiss Societe Cooperative and an "umbrella organization for its member firms worldwide." These bare allegations are insufficient to plead that Andersen acted as an agent of AWSC when it conducted the WorldCom audits, or to impute Andersen's knowledge or recklessness to AWSC.

Plaintiffs' reliance on *Suez Equity*, 250 F.3d 87, is misplaced. In that case, there were allegations that an individual defendant knowingly conveyed a false report to the plaintiffs. *Id.* at 100. It was alleged that he had acted as the agent for three related corporate entities in doing so: specifically, that he was the employee of one and acting on behalf of all three in managing their relationship with the plaintiffs. *Id.* Each of the three corporate defendants was alleged to have had a motive to commit the fraud. *Id.* Similarly, this Court's decision in *Cromer*, 2002 WL 826947, on which plaintiffs also rely, permitted plaintiffs to proceed on the theory that Deloitte Touche (Bermuda) had acted as the agent of Deloitte Touche Tohmatsu, and that the scienter of the member firm could be imputed to the international umbrella firm, where the complaint included specific allegations of a conveyance of actual authority. *Id.* at *3-8. The *Cromer* plaintiffs also alleged that the name and logo of the international umbrella organization appeared on the audits prepared by Deloitte Touche (Bermuda). *Id.* at *3.

In sum, plaintiffs' allegations are not sufficient to invoke an agency or partnership theory. As a consequence, the Section 10(b) claim against AWSC must be dismissed. [FN9]

FN9. Having dismissed the Section 10(b)

claim, AWSC's arguments that as a societe cooperative formed under the Swiss Code it is not susceptible to arguments based on a partnership or agency theory are not addressed. In addition, it is unnecessary to address its motion based on a lack of personal jurisdiction.

Fraudulent Scheme

As noted above, with the exception of Andersen, none of the defendants is alleged to have made a statement on which the plaintiffs relied. In an effort to salvage its claims against three of these defendants—Schoppet, Andersen UK and AWSC—the plaintiffs argue that these defendants are liable even if they did not make any untrue statements or omissions because Rule 10b-5 also creates a private cause of action against those who "employ any device, scheme or artifice to defraud." 17 C.F.R. § 240.10b-5(a). This argument suffers from two principle deficiencies. While the Complaint is replete with allegations of misrepresentations contained in the WorldCom financial statements and registrations statements, it does not allege the existence of any scheme or artifice in which these defendants participated. It does not identify any false information that these defendants contributed to a scheme or actions they took to facilitate a scheme. Moreover, to state a claim for use of a fraudulent scheme, plaintiffs must allege that defendants acted with scienter. *SEC v. Zandford*, 535 U.S. 813, 819-20, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). As already explained, plaintiffs' claims against Schoppet, Andersen UK, and AWSC have been dismissed for failure, *inter alia*, to plead scienter.

Conclusion

*11 For the reasons stated above, Arthur Andersen LLP's motion to dismiss is denied. The motions to dismiss brought by Arthur Andersen (United Kingdom), Mark Schoppet, Melvin Dick and Andersen Worldwide SC are granted. [FN10]

FN10. The plaintiffs have asked for leave to amend. Because of the numerous legal

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barriers to pleading a Section 10(b) claim against any of the dismissed defendants, leave to amend is denied. Should the plaintiffs seek to amend to replead claims against any of the four dismissed defendants, they must do so through a motion filed by August 1, 2003.

SO ORDERED:

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