UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE WORLDCOM, INC. SECURITIES LITIGATION	MASTER FILE 02 Civ. 3288 (DLC)
This Document Relates to:	
ALL ACTIONS	OPINION AND ORDER

For Lead Plaintiff:
Max W. Berger
John P. Coffey
Steven B. Singer
Chad Johnson
Beata Gocyk-Farber
John C. Browne
David R. Hassel
Bernstein Litowitz Berger & Grossman LLP
1285 Avenue of the Americas
New York, New York 10019

Leonard Barrack
Gerald J. Rodos
Jeffrey W. Golan
Mark R. Rosen
Jeffrey A. Barrack
Pearlette V. Toussant
Regina M. Calcaterra
Chad A. Carder
Barrack, Rodos & Bacine
3300 Two Commerce Square
2001 Market Street
Philadelphia, Pennsylvania 19103

For Defendant Bert C. Roberts, Jr.:
George E. Ridge
Cooper Ridge & Lantinberg, P.A.
200 West Forsyth Street, Suite 1200
Jacksonville, FL 32202

DENISE COTE, District Judge:

This Opinion describes the standards for imposing liability on directors of public companies under Section 11 of the Securities Act of 1933 ("Securities Act") and under the

controlling person provisions in the Securities Act and the Securities Exchange Act of 1934 ("Exchange Act"). Bert C. Roberts, Jr. ("Roberts"), the former chairman of the board of WorldCom, Inc. ("WorldCom"), has moved for summary judgment in the consolidated securities class action arising from WorldCom's collapse, relying principally upon the affirmative defenses available under each of these two statutes. Even though the Lead Plaintiff does not contend that Roberts knew of the accounting fraud which it alleges occurred at WorldCom, to avoid liability Roberts must nonetheless show that he conducted a reasonable investigation of the unaudited financial statements and other non-expertised material that were incorporated into registration statements through which WorldCom executed two massive bond offerings during Roberts' tenure at WorldCom, that he otherwise exercised due care, and that he had no reasonable ground to believe in the existence of the facts that underlie the Securities Act claim associated with the two bond offerings. Because questions of fact exist regarding each of these issues, and for the additional reasons described below, Roberts' motion for summary judgment is denied. Familiarity with prior Opinions issued in the WorldCom Securities Litigation is assumed.[1]

[1] See, e.g., In re WorldCom, Inc. Sec. Litig., 352 F. Supp. 2d 472 (Arthur Andersen LLP's motion for summary judgment); In re WorldCom, Inc. Sec. Litig., 346 F. Supp. 2d 628 (S.D.N.Y. 2004) (Underwriter Defendants' motion for summary judgment); In re WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 392 (S.D.N.Y. 2003) (deciding a number of defendants' motions to dismiss); In re WorldCom, Inc. Sec. Litig., 219 F.R.D. 267 (2003) (class certification).

Background

On June 25, 2002, WorldCom announced a massive restatement of its financial statements for 2001 and the first quarter of 2002. Several weeks later, the company entered bankruptcy. WorldCom ultimately made approximately $76 billion in financial adjustments for 2000 and 2001, reducing the company's net equity from approximately $50 billion to approximately minus $20 billion. It is undisputed that, at least as of early 2001, WorldCom executives engaged in a secretive scheme to misrepresent WorldCom's financial condition in the company's filings with the Securities and Exchange Commission ("SEC"). The Lead Plaintiff alleges that the scheme began even before 2001, and that the company's manipulated financials were incorporated into the registration statements for two enormous bond offerings in May 2000 and May 2001 (the "Offerings").

The facts underlying WorldCom's June 25 announcement spurred numerous lawsuits. The Judicial Panel on Multi-District Litigation transferred the securities-based actions from federal courts around the country to this Court, where they were consolidated into the Securities Litigation.[2] The consolidated class action is brought on behalf of a class of all persons and entities, excluding defendants and certain others affiliated with them or with WorldCom, who were financially injured after they acquired publicly traded WorldCom securities beginning April 29, 1999 through and including June 25, 2002 (the "Class Period").

[2] The Securities Litigation includes a number of individual actions as well as the consolidated class action that is the subject of this Opinion.

Roberts was chairman of WorldCom's board of directors throughout the Class Period. Immediately prior to his service as chairman of WorldCom, Roberts was chairman of the board of MCI. Roberts had worked at MCI since 1972, and had risen up the ranks at the telecommunications company, having formerly held positions as president of the company's long distance division, chief operating officer, president, and finally, as chief executive officer, in which capacity he served from 1991 to 1996. MCI was acquired by WorldCom on September 14, 1998, in a transaction valued at $40 billion. The acquisition made WorldCom the second largest telecommunications company in the world. Roberts asserts that his service as chairman of WorldCom's board after the acquisition was pursuant to a "stay put" contract; after the contract expired at the end of 1999, he stayed on as chairman at the request of WorldCom CEO Bernard J. Ebbers. Upon Roberts' arrival at WorldCom, in addition to his experience on the MCI board, he had been a director of a number of other public companies, including British Telephone, Telefonica, News Corporation, and Valence Technology, where Roberts was a member of the audit committee.

Roberts signed a number of documents filed by WorldCom with the SEC. These include the 1999, 2000, and 2001 Forms 10-K and the registration statements ("Registration Statements") for the 2000 and 2001 Offerings, as well as registration statements filed in connection with WorldCom's acquisition of SkyTel Communications, Inc. in 1999 and of Intermedia Communications, Inc. in 2001.

The Corrected First Amended Complaint of December 1, 2003 ("Complaint") asserted Securities Act claims against certain WorldCom officers, twelve WorldCom directors, WorldCom's auditor Arthur Andersen LLP ("Andersen"), and investment banks that underwrote the 2000 and 2001 Offerings. It asserted an Exchange Act fraud claim under Section 10(b) against several officers, one director, Andersen, and the Citigroup Defendants,[3] and Exchange Act controlling person claims against the twelve directors and certain officers.

With respect to Roberts in particular, the Complaint pleads claims under Sections 11 and 15 of the Securities Act. Section 11 liability stems from the requirements for filing a registration statement with the SEC. Section 15, a controlling-person provision, imposes liability upon those who control a person -- here alleged to be WorldCom, the issuer -- who committed an underlying Securities Act violation.[4] 15 U.S.C. § 77o. Roberts also faces a claim under Section 20(a) of the

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[3] The Citigroup Defendants are Citigroup, Inc., Citigroup Global Markets Inc. f/k/a Salomon Smith Barney Inc. ("SSB"), Citigroup Global Markets Limited f/k/a Salomon Brothers International Limited, and Jack B. Grubman. Their Section 10(b) liability was premised on SSB's role as a lead underwriter for the 2000 and 2001 Offerings and on Grubman's analyst reports encouraging investment in WorldCom. See WorldCom, 219 F.R.D. at 277.

[4] The Complaint asserted two underlying Securities Act claims, claims under Section 11 and Section 12(a)(2). Section 11 liability is premised on the issuance of a registration statement; Section 12(a)(2) liability is premised on the issuance of a prospectus. See WorldCom, 346 F. Supp. 2d at 656-60. The Lead Plaintiff alleged these violations in connection with the 2000 and 2001 Offerings and the documents that supported those Offerings.

Exchange Act. Like Section 15, Section 20(a) is a controlling-person provision. It imposes liability on those who control a person who committed an underlying Exchange Act violation such as securities fraud. 15 U.S.C. § 78t(a). Here again, the underlying violator is alleged to be WorldCom.

The Citigroup Defendants settled with the Lead Plaintiff in May 2004. See In re WorldCom, Inc. Sec. Litig., 02 Civ. 3288 (DLC), 2004 WL 2591402, at *1 (S.D.N.Y. Nov. 12, 2004). Trial against the remaining defendants was scheduled to begin on March 17, 2005. During the two weeks preceding trial, the remaining Underwriter Defendants settled. At that point, all of the Director Defendants except Roberts resurrected an aborted settlement agreement with the Lead Plaintiff.[5] Preliminary approval of that settlement is pending. The civil actions against the WorldCom officers have been stayed because each of them has been prosecuted for their conduct at WorldCom. Most recently, Bernard J. Ebbers, WorldCom's former CEO, was convicted following trial in this district. The defendants who are proceeding to trial in the class action are Andersen and Roberts. The trial begins March 22, 2005.

In his motion for summary judgment, Roberts argues that he has established his due diligence defense under Section 11 of the Securities Act as to both the "expertised" and non-expertised

[5] Ten Director Defendants had executed a settlement agreement with the Lead Plaintiff in January 2005. Because the Court found that that agreement violated the Private Securities Litigation Reform Act ("PSLRA"), the Lead Plaintiff withdrew from the settlement. See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288, 2005 WL 335201, at *1 (S.D.N.Y. Feb. 14, 2005).

portions of the registration statements at issue.[6] Roberts also maintains that he is not a "controlling person" under Section 20(a) of the Exchange Act because his conduct did not involve "culpable participation" in the underlying fraud as required by Second Circuit precedent. In addition, he argues that he has established the affirmative defenses available under both Section 20(a) and Section 15 of the Securities Act.

Discussion

Summary judgment may be granted only "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Rule 56(c), Fed. R. Civ. P.; see also Sec. Ins. Co. of Hartford v. Old Dominion Freight Line, Inc., 391 F.3d 77, 82 (2d Cir. 2004). "The burden of showing that no genuine factual dispute exists rests on the party seeking summary judgment, and in assessing the record to determine whether there is a genuine issue as to a material fact, the court is required to resolve all ambiguities and draw all permissible factual inferences in favor of the party against whom summary judgment is sought." Old Dominion Freight Line, 391 F.3d at 83 (citation omitted) (emphasis supplied).

When the moving party has asserted facts showing that it is entitled to summary judgment, the opposing party must "set forth

[6] For a description of expertised statements, see WorldCom, 346 F. Supp. 2d at 664.

specific facts showing that there is a genuine issue for trial," and cannot rest on the "mere allegations or denials" of the movant's pleadings. Rule 56(e), Fed. R. Civ. P.; accord Burt Rigid Box, Inc. v. Travelers Prop. Cas. Corp., 302 F.3d 83, 91 (2d Cir. 2002). If there is evidence, however, "from which a reasonable inference could be drawn in favor of the opposing party, summary judgment is improper." Old Dominion Freight Line, 391 F.3d at 83 (citation omitted). Moreover, "where the evidentiary matter in support of the motion does not establish the absence of a genuine issue, summary judgment must be denied even if no opposing evidentiary matter is presented." Id. (citation omitted) (emphasis in original).

I. The Section 11 affirmative defense of due diligence

As a director of WorldCom, Roberts is named as a defendant in the Complaint's Section 11 claim. As already noted, the Section 11 claim is premised on the Registration Statements filed by WorldCom for the 2000 and 2001 Offerings. Roberts asserts principally that he relied and was entitled to rely on the integrity of WorldCom's officers and the work of WorldCom's auditor in connection with the contents of the Registration Statements.

Section 11 "was designed to assure compliance with the disclosure provisions of the [Securities] Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering." Herman & MacLean v. Huddleston, 459 U.S. 375, 381-82 (1983). These parties will be found to have

violated Section 11 whenever "material facts have been omitted or presented in such a way as to obscure or distort their significance." I. Meyer Pincus & Assoc. v. Oppenheimer & Co., 936 F.2d 759, 761 (2d Cir. 1991) (citation omitted). While Section 11 is a strict liability statute, see, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 208 (1976), Section 11 provides an affirmative defense of "due diligence," which is available to defendants other than the issuer of the security.[7] See Huddleston, 459 U.S. at 382; Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 370-71 (2d Cir. 1973).

An earlier Opinion in this litigation discusses the "due diligence" affirmative defense at length, and this Opinion draws liberally from that discussion. WorldCom, 346 F. Supp. 2d at 662-66 ("Summary Judgment Opinion"). As described in the Summary Judgment Opinion, there are actually two affirmative defenses available under Section 11(b) that are collectively known as the "due diligence" defense. See 15 U.S.C. §§ 77k(b)(3)(A) & (b)(3)(C); 2 Gary M. Lawrence, Due Diligence in Business Transactions § 2.03A (2004). Courts have distinguished between these two standards by labeling them the due diligence defense and the reliance defense. See WorldCom, 346 F. Supp. 2d at 663 (collecting cases).

The due diligence defense provides that "as regards any part of the registration statement not purporting to be made on the

[7] In addition, Section 11 provides an affirmative defense where a defendant can prove that the loss in value of a security is due to something other than misleading statements within a registration statement. See 15 U.S.C. § 77k(e). Roberts has not moved for summary judgment on this affirmative defense.

authority of an expert," a defendant will not be liable upon a showing that

> he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

15 U.S.C. § 77k(b)(3)(A) (emphasis supplied). This defense is understood as "a negligence standard." Hochfelder, 425 U.S. at 208.

The less demanding reliance standard applies when a Section 11 defendant is entitled to rely upon the opinion of an expert. "[A]s regards any part of the registration statement purporting to be made on the authority of an expert," a defendant other than that expert will not be liable if he demonstrates that

> he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

15 U.S.C. § 77k(b)(3)(C) (emphasis supplied).

Although the requirements of due diligence vary depending on whether the registration statement has been made in part or in whole on the authority of an expert, the standard for determining what constitutes a reasonable investigation and reasonable ground for belief is the same: "[T]he standard of reasonableness shall be that required of a prudent man in the management of his own property." 15 U.S.C. § 77k(c).

A. Rule 176

The Summary Judgment Opinion not only featured a lengthy exposition of the case law surrounding the due diligence and reliance defenses, see WorldCom, 346 F. Supp. 2d at 671-78, but it also rejected the Underwriter Defendants' arguments that in creating the integrated disclosure system and shelf registration through rule making principally between the late 1960s and the early 1980s, and in enacting SEC Rule 176 in 1982, the SEC fundamentally altered the nature of underwriters' due diligence obligations. Id. at 667-70. Roberts' motion for summary judgment relies upon much of the same flawed analysis that was presented by the Underwriter Defendants and rejected in the Summary Judgment Opinion.

The SEC proposed Rule 176 in an attempt "to make explicit what circumstances may bear upon the determination of what constitutes a reasonable investigation and reasonable ground for belief as these terms are used in Section 11(b)." Id. at 669 (citation omitted). In finding that the SEC at no time intended to diminish an underwriter's obligation to make a reasonable investigation, as the statutory language demands, the Summary Judgment Opinion explored the purpose and meaning of Rule 176. In relevant part, Rule 176 provides:

> In determining whether or not the conduct of a person constitutes a reasonable investigation or a reasonable ground for belief meeting the standard set forth in section 11 (c), relevant circumstances include, with respect to a person other than the issuer. [sic]
>
> (a) The type of issuer;
>
> (b) The type of security;

> (c) The type of person;
>
> . . . .
>
> (e) The presence or absence of another relationship to the issuer when the person is a director or proposed director;
>
> (f) Reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the issuer and the filing);
>
> . . . .
>
> (h) Whether, with respect to a fact or document incorporated by reference, the particular person had any responsibility for the fact or document at the time of filing from which it was incorporated.

17 C.F.R. § 230.176 (emphasis supplied).

In proposing Rule 176, the SEC noted that "only a court can make the determination of whether a defendant's conduct was reasonable under all the circumstances of a particular offering." Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act, SEC Release No. 6335, 1981 WL 31062, at *13 (Aug. 6, 1981) ("SEC Release No. 6335"). Nonetheless, the SEC recognized that even though the same statutory language governs the due diligence obligations of directors; signers of registration statements; experts, such as accountants and appraisers; and underwriters, "Congress intended that there would be variation in the thoroughness of the investigation performed by the different persons subject to Section 11 liability based on the importance of their place in the scheme of distribution and with the degree of protection that the public has a right to expect." Id. at *14 (citation omitted)(emphasis supplied). The SEC directed that the due

diligence obligations of directors in particular be evaluated in light of "their continuing involvement in their company's activities," which includes "receiv[ing] reports, request[ing] information from management, meet[ing] periodically, and analyz[ing], plan[ning] and participat[ing] in the company's business." Id. at *12. Such activities, explained the SEC,

> provide a strong basis for their evaluation of disclosure in a registration statement, and for considering what further due diligence is necessary on their part. In particular, their roles in reviewing the company's Form 10-K annual report and other Exchange Act filings are relevant to their due diligence for a registration statement incorporating those filings.

Id.

The SEC also acknowledged that not all directors play the same role vis a vis the company, and that the differences in their roles had implications for their duty of diligence. Id. at *13-*14. Thus, among the circumstances listed in Rule 176 are two that were intended especially to bear on the extent to which directors are entitled to the due diligence and reliance defenses. First, Rule 176 provides that in the case of a director, a court should consider the presence or absence of another relationship to the issuer. 17 C.F.R. § 230.176(e). The SEC included this subsection to highlight that "a director who has another relationship with the issuer involving expertise, knowledge or responsibility with respect to any matter giving rise to the omission or misstatement will be held to a higher standard of investigation and belief than an outside director with no special knowledge or additional responsibility." SEC

Release No. 6335, 1981 WL 31062, at *14 (emphasis supplied). Second, Rule 176(f), which looks to whether a defendant has reasonably relied on "officers, employees, and others whose duties should have given them knowledge of the particular facts," 17 C.F.R. § 230.176(f), also was aimed, per the SEC's understanding of the legislative history of the Securities Act, at "avoid[ing] placing excessive burdens on the issuer's directors." SEC Release No. 6335, 1981 WL 31062, at *14 (citation omitted).

While concerns particular to directors have found expression in Rule 176, the overall impact of the rule on directors is no different than it is for underwriters. That is to say, as the SEC noted in 1981,

> The principal goal of integration is to simplify disclosure and reduce unnecessary repetition and redelivery of information which has already been provided, not to alter the roles of participants in the securities distribution process as originally contemplated by the Securities Act. The integrated disclosure system, past and proposed, is thus not designed to modify the responsibility of underwriters and others to make a reasonable investigation."

Id. at *10 (emphasis added). Indeed, just as underwriters' due diligence obligations remain fixed under Section 11(b)(3)(A), so too must directors -- "as has historically been the case with respect to unaudited information included in a registration statement" -- "demonstrate affirmatively . . . that, after conducting a reasonable investigation, they had reasonable ground to believe, and did believe, that the [non-expertised] information was true." Accountants' Liability Under Securities

Act of 1933 for Reports on Certain Unaudited Supplementary Financial Information, SEC Release No. 6208, 1980 WL 29981, at *4 (Apr. 30, 1980).

The SEC has also clarified that directors are not excused from performing a meaningful due diligence investigation due to the involvement of professionals, such as underwriters and auditors, in a given securities offering. For instance, a director must perform a "due diligence inquiry notwithstanding the use of a professional underwriter." New High Risk Ventures, SEC Release No. 5275, 1972 WL 125474, at *6 (July 27, 1972). Moreover, the SEC has made clear that accountants' reports on unaudited financial information do not constitute statements "purporting to be made on the authority of an expert" as defined in Section 11(b)(3)(C), and therefore, directors and underwriters alike "should be required . . . to demonstrate affirmatively under Section 11(b)(3)(A) that, after conducting a reasonable investigation, they had reasonable ground to believe, and did believe, that the interim financial data was true." Accountant Liability for Reports on Unaudited Interim Financial Information Under Securities Act of 1933, SEC Release No. 6173, 1979 WL 169953, at *4 (Dec. 28, 1979) (emphasis supplied).

B. Case Law: Reliance Defense

As the Summary Judgment Opinion recalls, the past four decades have produced scant development in the law surrounding a defendant's affirmative defenses under Section 11. WorldCom, 346 F. Supp. 2d at 671. The reliance defense was remarked upon,

however, by Justice Powell in his dissent from the Supreme Court's denial of certiorari in John Nuveen & Co. v. Sanders, 450 U.S. 1005 (1981), a case addressed to the requirements of Section 12(a)(2)'s reasonable care defense. The main thrust of Justice Powell's dissent in Sanders is an explanation of his view that as Congress "used its words with precision" in enacting the Securities Act and the Exchange Act, the duties imposed under Section 12(a)(2) cannot be equated with those under Section 11. In so doing, Justice Powell noted that Section 11

> explicitly absolve[s] [non-issuer defendants] of the duty to investigate with respect to "any part of the registration statement purporting to be made on the authority of an expert" such as a certified accountant if "he had no reasonable ground to believe and did not believe" that the information therein was misleading. This provision is in the Act because, almost by definition, it is reasonable to rely on financial statements certified by public accountants.

Id. at 1010 (emphasis supplied). Justice Powell further observed that "where breaches by accountants occur, it is the accountants themselves -- not those who rely in good faith on their professional expertise -- who are at fault and who should be held responsible." Id. n.4.

Thus, directors may rely on an accountant's audit opinion incorporated into a registration statement in presenting a reliance defense. WorldCom, 346 F. Supp. 2d at 666. In the seminal case of Escott v. BarChris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968), the Honorable Edward C. McLean of this district held that with respect to the expertised portion of the prospectus, an outside director prevailed on his reliance defense

by proving that he knew that the financial statements were audited, "believed them to be correct because he had confidence in [the auditor]," and "had no reasonable ground to believe otherwise." Id. at 688.

Nonetheless, just as "underwriters' reliance on audited financial statements may not be blind," WorldCom, 346 F. Supp. 2d at 672, directors also may not fend off liability by claiming reliance where "red flags" regarding the reliability of an audited financial statement, or any other expertised statement, emerge. The Summary Judgment Opinion, which largely denied summary judgment to the Underwriter Defendants, discusses at some length the concept of "red flags," which primarily appears in cases under Section 10(b) of the Exchange Act. Id. at 672-74. What constitutes a red flag is an exquisitely fact intensive inquiry that depends upon the circumstances surrounding a particular issuer, the alleged misstatements, and the role of the Section 11 defendant. See id. at 679.

C. Case Law: Due Diligence Defense

As described above, the due diligence defense offers directors an opportunity to escape liability under Section 11 through proof that they conducted a "reasonable investigation." 15 U.S.C. § 77k(b)(3)(a). For decades courts have recognized that what constitutes both a reasonable investigation and a reasonable belief in the accuracy of a registration statement hinges on a fact-intensive inquiry into, among other things, the nature of the individual director's relationship to the company.

In particular, courts have required a more searching inquiry by inside directors. Whether a director is properly categorized as an inside or outside director, however, the law has consistently placed upon directors the duty to conduct a reasonable investigation of the non-expertised portions of registration statements and has not permitted them simply to accept at face value the representations of management and auditors. After all, even honest auditors and officers of a company may make mistakes. See Bar Chris, 283 F. Supp. at 690.

With respect to the role of directors, Judge McLean wrote in BarChris:

> Section 11 imposes liability . . . upon a director, no matter how new he is. He is presumed to know his responsibility when he becomes a director. He can escape liability only by using that reasonable care to investigate the facts which a prudent man would employ in the management of his own property. In my opinion, a prudent man would not act in an important matter without any knowledge of the relevant facts, in sole reliance upon representations of persons who are comparative strangers and upon general information which does not purport to cover the particular case.

BarChris, 283 F. Supp. at 688 (emphasis supplied) (citation omitted).

With this framework in mind, Judge McLean found an outside director who had joined the company shortly before the issuance of the security in question and who had "little opportunity to familiarize himself with the company's affairs" liable under Section 11 because he made no investigation of the accuracy of the prospectus and relied exclusively on general assurances from company officers. Id. Judge McLean similarly found that another

outside director who had just joined the board did not establish his due diligence when he merely read an early version of the pertinent registration statement for "about ten minutes," signed the final document without reading it, and simply inquired of the company's officers whether the information in the registration statement was correct. Id. at 689.

A third director with a special relationship of the company and the offering was held to an even more exacting standard. This director was also a member of the law firm that served as the company's counsel and had drafted the registration statement. His "unique position" could not be "disregarded." Id. at 690. "[M]ore was required of him in the way of reasonable investigation than could fairly be expected of a director who had no connection with this work." Id. While observing that "requir[ing] an audit would obviously be unreasonable," Judge McLean found that the registration statement contained "errors and omissions . . . which could have been detected [by the third director] without an audit." Id. He observed that requiring this director to check matters that were "easily verifiable" was not unreasonable. Id. Had the director read pertinent contracts, required the minutes of certain corporate subsidiaries to be written up and reviewed them, examined corporate records regarding delinquencies, inquired more thoroughly of the company's officers, both through written submissions to them and oral conversations, and requested that the company's auditor investigate and report to him on critical items, see id. at 690-92, he would have obtained information that "would have put him

on his guard." Id. at 692. According to Judge McLean, the way "to prevent mistakes is to test oral information by examining the original written record." Id. at 690. Therefore, Judge McLean concluded that even "making due allowances for the fact that [the issuer's] officers misled him," and that the director was a man of integrity and had acted in good faith, he had also not met his due diligence obligations. Id.

Thus, while finding all three of the directors discussed above to be liable for their lack of due diligence, BarChris created "a sliding scale of liability" among directors, "draw[ing] a distinction between insiders and outsiders."[8] 1 Thomas Lee Hazen, Law of Sec. Reg. § 7.4[2][A][1] (4th ed. 2002). That distinction was cemented by the further exposition of the due diligence defense in Feit v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N.Y. 1971), in which the Honorable Jack B. Weinstein had occasion to consider the due diligence obligations of inside directors. As Judge Weinstein keenly observed, "what constitutes 'reasonable investigation' and a 'reasonable ground to believe' will vary with the degree of involvement of the individual, his expertise, and his access to the pertinent information and data. What is reasonable for one

[8] Since the PSLRA, whether a defendant is an inside or outside director bears not only on the director's due diligence obligations under Section 11(b)(3), but also on a director's ultimate liability for a Section 11 violation. See 15 U.S.C. §§ 78u-4(f)(2), 78u-4(f)(10)(C)(ii) (providing that outside directors are only liable for the portion of the judgment that corresponds to their percentage of responsibility unless their violations were committed knowingly); WorldCom, 2005 WL 335201, at *2.

director may not be reasonable for another by virtue of their differing positions." Id. at 577-78. Given this, Judge Weinstein explained that "[i]nside directors with intimate knowledge of corporate affairs and of the particular transactions will be expected to make a more complete investigation and have more extensive knowledge of facts supporting or contradicting inclusions in the registration statements than outside directors." Id. at 578. Indeed, Feit emphasizes that the duty of inquiry placed upon inside directors is so stringent that "liability will lie in practically all cases of misrepresentation." Id.

Since BarChris and Feit, other courts have similarly imposed a division between the due diligence obligations of inside directors and those of outside directors. For instance, the court in Goldstein v. Alodex Corp., 409 F. Supp. 1201 (E.D. Pa. 1976), observed that the situation of outside directors was "legally and factually different from that of the corporation and the other inside directors." Id. at 1203 n.1. Citing Feit, 332 F. Supp. at 544, and BarChris, 283 F. Supp. at 643, the Goldstein court announced:

> The law is that an inside director with intimate knowledge of corporate affairs and of particular transactions is expected to make a more complete investigation and to have more extensive knowledge of the facts supporting the statement than is an outside director, although each must undertake that investigation which a reasonable prudent man in that position would conduct.

Id.

While courts have distinguished between the due diligence obligations of inside and outside directors, a serious question lingers over who precisely counts as an outside director. Within the Section 11 case law, an outside director is alternately a director who is not an officer, BarChris, 283 F. Supp. at 687, a director who is neither an officer nor an employee, see Goldstein, 409 F. Supp. 2d at 1203, or someone who, based on an assessment of the pertinent facts and circumstances, is simply not "so deeply involved that he is really an insider." Feit, 332 F. Supp. at 576 (citation omitted). The lack of a uniform understanding of who is an outside director within the case law is exacerbated by the SEC's failure to promulgate its own definition of inside and outside directors for the purposes of Section 11, despite Congress's explicit instruction within the PSLRA that it define the term "outside director." See 15 U.S.C. § 78u-4(f)(10)(D). Nonetheless, at least one commentator has postulated that an outside director "is a director who fits the definition of a 'Non-Employee Director' contained in [SEC] Rule 16b-3(b)(3),"[9] a somewhat intricate regulation. 5 Arnold S.

[9] Rule 16b-3(b)(3) defines a Non-Employee Director as a director who:

> (A) Is not currently an officer (as defined in § 240.16a-1(f)) of the issuer or a parent or subsidiary of the issuer, or otherwise currently employed by the issuer or a parent or subsidiary of the issuer;
> (B) Does not receive compensation, either directly or indirectly, from the issuer or a parent or subsidiary of the issuer, for services rendered as a consultant or in any capacity other than as a director, except for an amount that does not exceed the dollar amount for which disclosure would be required pursuant to [Item 404(a) of Regulation S-K];

Jacobs, Disclosure & Remedies Under the Sec. Laws § 3:87 (West 2005). In addition, certain institutions of significance to our capital markets, such as the New York Stock Exchange ("NYSE"), have their own formalized definitions of the term "outside director." The NYSE, for instance, considers an outside director to be

> a director who is not an employee, officer, or former officer of the listing firm or one of its subsidiaries or divisions, or a relative of a principal executive of the firm, or an individual or member of an organization acting as an advisor, consultant, legal counsel, receiving compensation on a continuing basis from the company other than director's fees.

Jonathan R. Macey & Hideki Kanda, The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges, 75 Cornell L. Rev. 1007, 1022 n.55 (1990) (citation omitted); see also 14 Guy P. Lander, U.S. Sec. Law for Fin. Trans. § 3:12 n.3 (West 2005).

D. Application of the Law to Roberts' Motion

In his motion for summary judgment, Roberts argues that with respect to the expertised portions of the registration statements, he is entitled to summary judgment on the Section 11

> (C) Does not possess an interest in any other transaction for which disclosure would be required pursuant to [Item 404(a) of Regulation S-K]; and
> (D) Is not engaged in a business relationship for which disclosure would be required pursuant to [Item 404(b) of Regulation S-K].

17 C.F.R. § 240.16b-3(b)(3).

claim against him because he relied on the financial statements prepared by Andersen and believed them to be correct "because he had confidence in Arthur Andersen and because they were consistent with the explanations and presentations made to him by WorldCom's senior management and the Audit Committee." Roberts further alleges that his own "regular reviews" of these financial statements brought "nothing to his attention that caused him to question the financial information that was presented." Turning to the non-expertised portions of the registration statements, Roberts again phrases his argument in terms of reliance, contending that he "reasonably relied on the organization, the management personnel, and the obvious compliance by [WorldCom] with modern corporate governance standards," and pointing to Rule 176(f) as support for his actions. He asserts that WorldCom's CFO presented detailed, substantial analyses to the Board that demonstrated his competence. Implicit in Roberts' argument is his contention that he was an outside director with correspondingly reduced due diligence obligations.

Roberts' motion is premised on several erroneous statements of law, not the least of which is his argument, stated most clearly within his reply brief, that "whether audited or unaudited," all of the financial statements reviewed by Andersen are expertised within the meaning of Section 11. The Summary Judgment Opinion addressed this issue squarely, finding that as a matter of statutory interpretation and SEC regulation, unaudited financial information is not expertised, and thus, Section 11

defendants may not claim the reliance defense with respect to unaudited financial information and must show that they conducted a reasonable investigation of all portions of a registration statement except the audited financial statements. See WorldCom, 346 F. Supp. 2d at 664-665.

Even as to the audited financial statements, where a reliance defense is appropriate, Roberts' motion must fail. The Lead Plaintiff has pointed to information, most notably the decline in WorldCom's line costs[10] as a percentage of revenue, that a jury may find should have raised a red flag for Roberts and caused him to question his reliance on the audited financial statements. This is particularly true given Roberts' history within and expertise in the telecommunications industry. While Roberts has an explanation for why he accepted management's explanation regarding WorldCom's singular success in this regard, that explanation serves to highlight that this is a disputed issue of fact for trial. If the line cost data was a red flag, then Roberts had an obligation to inquire until satisfied as to the integrity of the line cost data.

Aside from Roberts' significant errors of law, he has also not fulfilled his burden of proof with respect to his due diligence defense. A defendant's assertion of the due diligence defense requires an exquisitely fact intensive inquiry into all

[10] Line costs were WorldCom's single largest operating expense. They were so significant to the health of the company that there were separately reported on its financial statements. See WorldCom, 346 F. Supp. 2d at 640.

of the circumstances surrounding the facts upon which the Section 11 claim is premised, including the factors set out in Rule 176. Although such fact-intensive inquiries do not lend themselves easily to resolution on summary judgment, with a properly supported motion it is conceivable that summary judgment could be granted, particularly when brought on behalf of an outside director. Without recognition of the burden placed by this defense on the director to demonstrate diligence, however, a motion for summary judgment is doomed.

Here, the parties dispute whether Roberts should be considered an inside or outside director, a classification that weighs heavily on any evaluation of Roberts' argument that he is entitled to summary judgment on his due diligence defense.[11] Even assuming that Roberts were able to show that he is properly considered an outside director, however, Roberts has not shown that he is entitled to summary judgment. He has not shown that he conducted any sort of investigation, much less a reasonable investigation in light of all relevant circumstances; instead, he has emphasized his "intelligent and well-reasoned reliance" on his fellow directors, experts, and professionals who were in the position to evaluate WorldCom, and his review of the materials management gave to the Board. While reliance on management's presentations to the Board, after a careful examination of the

[11] Roberts did not move for summary judgment on the issue of whether he was an outside director. His discussion of this issue recognizes that it is hotly contested.

materials provided to the Board, may suffice in some cases, the assertions in this case raise questions as to whether it was incumbent on Roberts to engage in a more active dialogue with management and perhaps even with the Company's auditors and underwriters. A motion for summary judgment requires a defendant to present evidence that establishes the absence of a genuine issue of fact; Roberts has not done that.[12]

II. Controlling-person liability under Section 20(a)

The Lead Plaintiff alleges that WorldCom committed a violation of Exchange Act Section 10(b) and SEC Rule 10b-5, and that the WorldCom directors, including Roberts, were controlling persons of WorldCom within the meaning of Section 20(a). Exchange Act Section 20(a) creates a cause of action against "controlling persons" of those engaged in the primary securities fraud. "'Controlling-person liability' is a separate inquiry from that of primary liability and provides an alternative basis of culpability." In re Scholastic Corp. Sec. Litig., 252 F.3d 63, 77 (2d Cir. 2001). Section 20(a) provides, in its entirety:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling

[12] Roberts' citation to Laven v. Flanagan, 695 F. Supp. 800 (D.N.J. 1988), is misplaced. The directors in Laven made a detailed showing that differentiated their due diligence activities from the "passive and total reliance on company management that defeated the due diligence defense" in BarChris. Id. at 812.

> person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a) (emphasis supplied). Under Second Circuit law,[13] to prove a Section 20 claim, "a plaintiff must show (1) a primary violation by a controlled person; (2) control of the primary violator by the defendant; and (3) 'that the controlling person was in some meaningful sense a culpable participant' in the primary violation." Boguslavsky v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998) (quoting SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996)). Control is defined in 17 C.F.R. § 240.12b-2 as "the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." See also First Jersey, 101 F.3d at 1472-73 (adopting this standard for a Section 20(a) claim).

A. "Culpable participation"

Roberts argues that the "culpable participation" requirement recited in Second Circuit case law as an element of a Section 20(a) claim means that recklessness or knowledge must be proved to establish liability under the provision. In support of his contention that scienter is required, Roberts cites several cases from this District, including In re Livent Securities Litigation,

[13] The Supreme Court has never elaborated on the elements of a Section 20(a) claim. See In re Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 392 (S.D.N.Y. 2003).

148 F. Supp. 2d 331, 355 (S.D.N.Y. 2001), and Gabriel Capital, L.P. v. NatWest Finance Inc., 122 F. Supp. 2d 407, 429 (S.D.N.Y. 2000). The Lead Plaintiff counters that the Opinion addressing motions to dismiss in this litigation has already held that Section 20(a) imposes no scienter requirement. See WorldCom, 294 F. Supp. 2d at 392 ("Motion to Dismiss Opinion"). Moreover, it contends that there is enough evidence to establish that Roberts was reckless in approving and signing the Registration Statements in any event.

The Motion to Dismiss Opinion noted the confusion among courts regarding the meaning of the "culpable participation" requirement. See id. at 414 (collecting authority). After examining the language of Section 20(a) and the applicable Second Circuit case law, see id. at 414-16, the Opinion concluded that "it does not appear that there is any requirement that the plaintiff plead or prove a culpable state of mind to allege or establish culpable participation." Id. at 415;[14] see also Initial Pub. Offering, 241 F. Supp. 2d at 392-97 (performing a thorough analysis of the relevant case law and legislative history and reaching the same conclusion).

[14] Although the issue in the Motion to Dismiss Opinion was specifically whether the complaint needed to plead scienter to state a Section 20(a) claim, the burden of proving such liability was considered in that Opinion in light of the requirement under the PSLRA that a heightened pleading standard be imposed if the plaintiff is required to prove a culpable state of mind at any point in the proceedings. See id. at 414 (citing 15 U.S.C. 78u-4(b)(2)).

There is no basis in the language of Section 20(a) itself to support a scienter requirement; the provision states simply that it covers every person who "directly or indirectly controls" an Exchange Act violator and provides for an affirmative defense of good faith and non-inducement. 15 U.S.C. § 78t(a); see also First Jersey, 101 F.3d at 1473 (characterizing the affirmative defense as such). Citing Section 20(a) among other provisions, the Supreme Court has stated that "[i]n each instance that Congress created express civil liability in favor of purchasers or sellers of securities it clearly specified whether recovery was to be premised on knowing or intentional conduct, negligence, or entirely innocent mistake." Hochfelder, 425 U.S. at 207. To read a scienter requirement into the prima facie case for a Section 20(a) claim would unreasonably strain the plain language of a clearly written provision.[15]

The Second Circuit has noted that Section 20(a) parallels Securities Act Section 15, see, e.g., Marbury Mgmt. v. Kohn, 629 F.2d 705, 714 (2d Cir. 1980), and there is little dispute that the latter provision contains no scienter requirement.[16] Moreover, "whenever the Second Circuit has applied its own test, it has essentially rendered the 'culpable participation'

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[15] In holding that scienter is not required to establish a Section 20(a) violation, the Court finds itself in respectful disagreement with the district court opinions cited by Roberts.

[16] A few courts have imposed a "culpable participation" requirement, which they have further construed to require scienter, for Section 15 claims, but they are outliers.

requirement meaningless." Initial Pub. Offering, 241 F. Supp. at 395 (emphasis in original).

For example, Marbury considered whether the district court was in error when it refused to pass on a plaintiff's Section 20(a) claim at trial. The appellate court evaluated whether a claim was supported in the trial record and found that it was, without making any reference to scienter. See Marbury, 629 F.2d at 710-12 (2d Cir. 1980). In First Jersey, the court affirmed a bench trial determination of Section 20(a) liability, again without reference to whether the plaintiff had presented evidence of scienter: "[T]here can be no question that [the defendant] was a controlling person with respect to [the brokerage against whom a Section 10(b) claim had been proved]. Hence, in order to escape controlling-person liability, [the defendant] had the burden of showing [the elements of the affirmative defense]." First Jersey, 101 F.3d at 1473. Roberts' motion for summary judgment on the ground that the Lead Plaintiff has not submitted evidence of recklessness or knowledge of the underlying fraud is accordingly denied.[17]

B. Affirmative defense of good faith and non-inducement

Roberts also claims that he is entitled to the affirmative defense of Section 20(a), which exempts a controlling person from

[17] Because no scienter is required to make out a prima facie case under Section 20(a), the issue of whether the evidence is sufficient to support an allegation of recklessness need not be reached.

liability if "the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the [underlying] violation or cause of action." 15 U.S.C. § 78t(a) (emphasis supplied). The Second Circuit has held that to establish good faith under Section 20(a), "the controlling person must prove that he exercised due care in his supervision of the violator's activities in that he maintained and enforced a reasonable and proper system of supervision and internal controls." First Jersey, 101 F.3d at 1473 (emphasis supplied) (citation omitted).[18] Additionally, to establish the second prong of the affirmative defense, the controlling person must prove that he did not directly or indirectly induce the underlying fraud. See id.

Roberts attests to his confidence in the company, its management, and its prospects prior to June 25, 2002. He also notes that he owned more than $30 million of WorldCom stock after the MCI-WorldCom merger. He retained all of his shares of WorldCom stock while a director of the company and even acquired more company-issued stock while a director.

The Lead Plaintiff argues that Roberts' act of signing the Registration Statements was by itself sufficient to constitute "inducement," citing Nordstrom, Inc. v. Chubb & Son, Inc., 54

[18] The Second Circuit has elaborated on this prong of the affirmative defense primarily in cases involving errant employees of broker-dealers, but has never indicated that the requirement of due care in the supervision of the controlled person's activities is limited to that context.

F.3d 1424, 1434 (9th Cir. 1995). It also disputes whether Roberts (and the other directors) enforced a reasonable and proper system of supervision at WorldCom, noting as an example the functioning of WorldCom's Internal Audit Department ("Internal Audit"), which conducted operational audits, while financial audits were left entirely to Andersen. Although Internal Audit made hundreds of internal control recommendations to the Audit Committee of WorldCom's Board of Directors ("Audit Committee"), no one on the Audit Committee questioned the absence of any such recommendations from Andersen. Cf. In re WorldCom Sec. Litig., No. 02 Civ. 3288 (DLC), 2005 WL 375313, at *12 (Feb. 17, 2005) (noting the Lead Plaintiff's intent to introduce evidence tending to show that Andersen, in contrast to its successor, failed to alert management to the fact that there were inadequate internal controls at WorldCom during the Class Period). In addition, the Lead Plaintiff notes that Roberts "fails to state anything he affirmatively did to ensure WorldCom's Audit Committee was discharging its duties consistent with its charter."

In Nordstrom, the directors and officers facing Section 20(a) liability had signed a series of public disclosures and press releases "downplaying the importance" of allegations that the company had violated wage laws. Nordstrom, 54 F.3d at 1427-28. The Ninth Circuit held that the directors and officers could not succeed on the affirmative defense, although they "believed in good faith that they were not perpetrating a fraud," because

they had "induced" the fraud when they approved the public disclosures. Id. at 1434. "By authorizing the misleading statements, the . . . directors and officers induced the fraud." Id.

To hold that Roberts "induced" the acts constituting the fraud at WorldCom merely by lending his signature to the Registration Statements would vitiate the affirmative defense to Section 20(a) liability. It is more likely that inducement should be understood to involve proof that the defendant undertook some action that caused the fraud. The dictionary definition of "induce" is "[t]o lead or move, as to a course of action, by influence or persuasion"; "[t]o bring about or stimulate the occurrence of; to cause." Am. Heritage Dictionary of the English Language (4th ed. 2000). The Lead Plaintiff cites to no evidence alleging that Roberts in any way influenced or caused the manipulation of financials that constituted the underlying fraud that the Lead Plaintiff alleges occurred at WorldCom.

Nevertheless, whether Roberts is entitled to the affirmative defense cannot be determined as a matter of law from the evidence at hand. Even though the Lead Plaintiff does not offer evidence that Roberts induced the misrepresentations underlying the Section 10(b) claim, whether Roberts acted with due care and did his part to assure that an adequate system of internal controls existed at WorldCom -- and thus, whether he has established the

good faith prong of the affirmative defense -- remains a disputed question of fact for the jury to decide.

Roberts has the burden of proof in establishing the affirmative defense. He points to no evidence establishing that he exercised the appropriate level of due care.[19] As has been noted by another court reviewing the assertion of an affirmative defense to a Section 20 claim, on a motion for summary judgment "[i]t is not enough . . . to demonstrate that plaintiffs fall short of producing evidence of culpable conduct; rather, the defendant must put forth [his] own evidence of [the Section 20(a) good faith defense] sufficient to direct a conclusion of law that [he] is entitled to the defense." In re Boesky Sec. Litig., Nos. 732, M21-45-MP, 1995 WL 456368, at *1 (S.D.N.Y Aug. 1, 1995) (Pollack, J.). Indeed, Roberts' motion does not even cite the appropriate Second Circuit law elaborating that "good faith" means due care in enforcing a reasonable and proper system of supervision and internal controls. Confidence in the company's existing management and prospects is not sufficient to prove good faith. Moreover, although Roberts' continuous stock ownership may be relevant evidence that Roberts was motivated to act to

[19] Much of the evidence cited by the Lead Plaintiff deals with the Audit Committee's inaction, which might suffice to defeat summary judgment for Audit Committee members, but is of questionable adequacy to counter evidence regarding a non-Audit Committee director such as Roberts. It is unnecessary to decide if evidence of Audit Committee oversights could be imputed to other board members through a duty on their part "affirmatively . . . to assure WorldCom's Audit Committee was discharging its duties consistent with its charter," as the Lead Plaintiff claims, since Roberts' motion must be denied for other reasons.

assure WorldCom's long-term financial well-being and was unaware of any fraud, it is far from conclusive evidence that he exercised due care in his duties. Cf. In re Ashanti Goldfields Sec. Litig., No. CV 00-0717 (DGT), 2004 WL 626810, at *5 (E.D.N.Y. Mar. 30, 2004) (holding that defendants' purchases of stock did not negate an inference of scienter on a motion to dismiss). Summary judgment is therefore denied.

III. Controlling-person liability under Section 15

Roberts asserts that he is entitled to summary judgment on the affirmative defense to liability under Section 15 of the Securities Act. Section 15 provides that "[e]very person who, by or through stock ownership, agency, or otherwise . . . controls any person liable under section 11 or 12, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable . . . ." 15 U.S.C. § 77o. In order to establish a prima facie case for Section 15 liability, a plaintiff must prove (1) control and (2) an underlying Section 11 or Section 12(a)(2) violation. In re Deutsche Telekom AG Sec. Litig., No. 00 Civ. 9475 (SHS), 2002 WL 244597, at *5-*6 (S.D.N.Y. Feb. 20, 2002).[20]

[20] Some district courts within this circuit have applied a "culpable participation" requirement to Section 15 claims, which some courts have further interpreted to involve scienter. See In re Philip Servs. Corp. Sec. Litig., No. 98 Civ. 0835 (MBM), 2004 WL 1152501, at *21 (S.D.N.Y. May 24, 2004) (noting the "intra-circuit debate," but declining to reach the issue). This reading of Section 15 is unsupportable, however, particularly given the statutory language and the Supreme Court's acknowledgment, when

Section 15 contains an affirmative defense to controlling-person liability. A controlling person will not be liable if he "had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." 15 U.S.C. § 77o (emphasis supplied). The portion of this defense that allows a defendant to show that he had "no reasonable ground to believe" of the underlying violation echoes a portion of the reliance defense available to Section 11 defendants. As described above, Section 11 allows a defendant to avoid liability if he shows that he had "no reasonable ground to believe" that the expertised portions of a registration statement contained misrepresentations or material omissions. And again, as already described, Section 11(c) defines reasonableness. Because "identical words used in different parts of the same act are intended to have the same meaning," Dep't of Revenue v. ACF Indus., Inc., 510 U.S. 332, 342 (1994) (citation omitted), Section 11(c) lends guidance as to what "reasonableness" means under Section 15. Section 11(c) defines the standard of reasonableness as "that required of a prudent man in the management of his own property." 15 U.S.C. § 77k(c).

In support of his argument that he is entitled to summary judgment on the affirmative defense provided within Section 15,

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considering Section 15 in conjunction with its affirmative defense, that the claim imposes a negligence standard only. See Hochfelder, 425 U.S. at 208-09 & n.27.

Roberts notes that there is no evidence in the record that he had any knowledge of any improper financial reporting or accounting until June 20, 2002, and he attests that he had no knowledge of the improprieties before that date. In addition, he notes that WorldCom's CFO, Scott Sullivan, regularly furnished "credible information and explanations of [WorldCom's] financial performance" to the board; that Arthur Andersen "regularly, consistently, and independently rendered clean, unqualified opinions" on the annual financial statements; that independent analysts consistently maintained high ratings on WorldCom's stock and bonds; that the SEC found no grounds to comment on the materials used in the 2000 and 2001 Offerings; and that there is evidence that WorldCom officers concealed the financial improprieties from the board members, Arthur Andersen, and others. Roberts submits that all of these factors show that he had reasonable ground to believe that the Registration Statements were accurate.

The Lead Plaintiff does not claim that Roberts "knew" of any financial improprieties at WorldCom. The Section 15 defense nonetheless requires Roberts to show that there is no material disputed issue of fact that he had no reasonable ground to believe in the facts constituting the violation. The Lead Plaintiff has offered evidence that raises questions of fact as to Roberts' invocation of this affirmative defense. Given Roberts' extensive experience in the telecommunications industry, coupled with what the Lead Plaintiff characterizes as the "great

divergence" between the line cost ratios that were reported by WorldCom, by MCI prior to its merger with WorldCom, and by WorldCom's chief competitors, a reasonable jury could find that Roberts had a reasonable ground to believe that financial improprieties were afoot.[21] The Lead Plaintiff also disputes whether much of the evidence Roberts cites actually suffices to support the reasonableness of his belief that the financial statements were accurate. Because sufficient evidence exists to create a question of fact regarding whether Roberts had no reasonable grounds to believe that financial improprieties were present, however, the sufficiency of this evidence need not be considered here. Roberts' motion for summary judgment on this count is therefore denied.

[21] For an explanation of why the differential in the ratio of line cost expenses to revenue between WorldCom and its competitors could be found by a jury to have been a "red flag," see WorldCom, 346 F. Supp. 2d at 640, 678-81. The same basic analysis may be found to apply to whether Roberts, who had extensive knowledge of the telecommunications industry in general and of MCI in particular, should have been alerted by the discrepancy that existed between MCI's historical line cost ratios and those which were reported by WorldCom during the Class Period.

Conclusion

Roberts' motion for summary judgment is denied in its entirety.

SO ORDERED:

Dated: New York, New York
March 21, 2005

DENISE COTE
United States District Judge