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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF OKLAHOMA

**FILED**  
APR 02 2004  
Phil Lombardi, Clerk  
U.S. DISTRICT COURT

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| IN RE WILLIAMS SECURITIES              | ) |                        |
| LITIGATION                             | ) | Case No. 02-CV-72-H(M) |
|  | ) | Lead Case              |
| This Document Relates to: WMB Subclass | ) |                        |
|  | ) | Judge Sven Erik Holmes |

**MOTION AND BRIEF FOR PARTIAL SUMMARY JUDGMENT AGAINST ERNST & YOUNG, LLP AS TO THE \$750 MILLION GUARANTEE**

**I. The Motion**

HGK, Lead Plaintiff for the WMB Subclass, moves for partial summary judgment under Rule 56, Fed.R.Civ.P., against Ernst & Young, LLP ("Ernst & Young" or "E&Y"), as to its liability (with damages to be determined at a later time) under Section 11 of the Securities Act of 1933 for failure to disclose the existence and terms of WMB's \$750 million guarantee concerning the Asset Defeasance Program obligations of Williams Communications Group, Inc. ("WCG"), to:

- A. Purchasers of approximately 30,000,000 shares of WMB common stock valued at \$1.2 billion, issued as a result of the August 2, 2001 merger of Barrett Resources Corporation into WMB (pursuant to a Registration Statement filed on June 15, 2001, and amendments thereto); and
- B. Purchasers of \$750 million of WMB 7.125% Notes due September 1, 2001 and purchasers of \$750 million of WMB 7.875% Notes due September 2021 sold on August 16, 2001 (pursuant to a Registration Statement filed on June 22, 2001, and amendments thereto).

**II. The Undisputed Material Facts**

1. As of April 23, 2001, WMB spun off to its shareholders common stock of WCG. Until April 23, 2001 WCG was a "majority-owned subsidiary" of WMB, where WMB owned approximately 98% of the voting power of WCG. See Tab 1 of the Appendix. Prior to October 6, 1999 WMB owned 100% of WCG. See Williams Defendants' Answer 149.
2. As of April 23, 2001, WMB had guaranteed the Asset Defeasance Program of WCG, such that (a)

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WCG could exercise its option to purchase, for \$750 million, the assets in the Asset Defeasance Program; (b) if WCG exercised such option to purchase, WMB would be obligated to pay the \$750 million purchase price; (c) WMB could not take possession of the assets in the Asset Defeasance Program and would not only have to leave those assets with WCG, but subordinate them to the interests of WCG's revolving credit facility lenders; (d) WMB could not initiate collection efforts against WCG for the \$750 million paid by WMB pursuant to its guarantee of the Asset Defeasance Program until one year after the maturity of WCG's revolving credit facility. See Tab 2 of the Appendix, WMB 2001 third quarter 10-Q. See Williams Defendants' Answer 190.

3. On June 15, 2001 WMB filed a Registration Statement (the "Barrett Resources Registration Statement") with the Securities and Exchange Commission, see Tab 3 of the Appendix, pp. 1 of 181 through 181 of 181, pursuant to which on August 2, 2001 it issued approximately 30,000,000 shares of WMB Common Stock to shareholders of Barrett Resources Corporation valued at \$1.2 billion. See Tab 3 of the Appendix, pp. 9-10 of 187 (\$73.63 times 16,730,502 shares).

4. On June 22, 2001 WMB filed a Registration Statement (the "Notes Registration Statement") with the Securities and Exchange Commission, pursuant to which on August 16, 2001 WMB sold \$750 million of WMB 7.125% Notes due September 1, 2011 and \$750 million of WMB 7.875% Notes due September 1, 2021. See Tab 4 of the Appendix.

5. The earnings of WMB for the fiscal year ending December 31, 1999 were \$161.8 million. See Tab 6 of the Appendix.

6. The earnings of WMB for the fiscal year ending December 31, 2000 were \$524.3 million. See Tab 7 of the Appendix, p. 61.

7. The earnings of WMB for the fiscal year ending December 31, 2001 were a net loss of \$477.7 million. See Tab 15 of the Appendix.

8. The earnings of WMB for the three months ending March 31, 2001 were \$199 million. See Tab 9 of the Appendix.

9. On January 29, 2002 WMB announced it was withholding an estimate of its earnings for fiscal

2001 while it assessed the impact, "if any," of its obligations under the \$750 million guarantee of the Asset Defeasance Program (and its obligations under a separate \$1.4 billion guarantee). *See* Tab 13 of the Appendix.

10. On March 7, 2002 WMB announced in its 2001 10-K that it was taking a \$2.05 billion charge against its earnings for 80% of its obligations in respect of WCG (including the Asset Defeasance Program guarantee set forth in Paragraph 2, above), being unable to tell if there was a difference in likelihood between 80% and 100% of ultimate loss. *See* Tab 14 of the Appendix.

11. On March 8, 2002 WCG exercised its option to acquire the assets in the Asset Defeasance Program, and WMB paid \$754 million in connection therewith. *See* Tab 12 of the Appendix.

12. In 1999 WCG's loss was \$359.7 million. *See* Tab 16 of the Appendix.

13. In 2000 WCG's loss was \$822.6 million. *See* Tab 17 of the Appendix.

14. For the first three months of 2001, WCG's loss was \$306.6 million. *See* Tab 5 of the Appendix.

On August 1, 2001, WCG reported losses for the second quarter of 2001 of \$250.1 million. *See* Tab 10 of the Appendix. On August 3, 2001 WCG filed an 8-K saying it expected losses in 2001 of \$1.1 billion. *See* Tab 11 of the Appendix.

15. On July 19, 2001 Moody's lowered WCG's credit rating to below Ba3, thereby allowing WCG's lenders to ask for liens on substantially all of WCG's assets. *See* Williams Defendants' Answer 223.

16. Ernst & Young consented to the usage of its report on the 2000 financial statements of WMB in the Barrett Resources Registration Statement:

**CONSENT OF INDEPENDENT AUDITORS**

We consent to the reference to our firm under the caption "Experts" report dated February 28, 2001, except for the matters described in Note 3, as to which the date is April 23, 2001, with respect to the consolidated financial statements and schedules of The Williams Companies, Inc. included in its Current Report on Form 8-K filed May 22, 2001 with the Securities and Exchange Commission, incorporated by reference in the Proxy Statement of Barrett Resources Corporation that is made part of the Registration Statement on Form S-4 and Prospectus of The Williams Companies, Inc. For the registration of 31,596,679 shares of The Williams Companies, Inc. common stock.

ERNST & YOUNG LLP

Tab 31 of the Appendix.

17. Ernst & Young consented to the usage of its report on the 2000 financial statements of WMB in the Notes Registration Statement:

**CONSENT OF INDEPENDENT AUDITORS**

We consent to the reference to our firm under the caption "Experts" in the Registration Statement (Form S-3) and related Prospectus of the Williams Companies, Inc. for the registration of up to \$1,924,056,250 of Debt Securities, Preferred Stock, Common Stock and/or Preferred Stock Purchase Rights, and to the incorporation by reference therein of our report dated February 28, 2001, except for the matters described in Note 3, as to which the date is April 23, 2001, with respect to the consolidated financial statements and schedules of The Williams Companies, Inc. included in its Current Report on Form 8-K filed with the Securities and Exchange Commission on May 22, 2001.

ERNST & YOUNG LLP

Tab 32 of the Appendix.

18. Note 3 to Ernst & Young's report on the 2000 financial statements of WMB, which it consented to usage of in the Registration Statements for the Barrett Resources Offering and the Notes Offering, says:

**NOTE 3. DISCONTINUED OPERATIONS**

Williams Communications Group, Inc.

On March 30, 2001, the board of directors of Williams approved a tax-free spinoff of WCG to Williams' shareholders...

Williams, prior to the spinoff and in an effort to strengthen [WCG's] capital structure, entered into an agreement under which Williams contributed an outstanding promissory note from [WCG] of approximately \$975 million and certain other assets, including a building under construction. In return, Williams received 24.3 million newly issued common shares of [WCG]. Williams is also providing indirect credit support through a commitment to issue Williams' equity in the event of a [WCG] default, or to the extent proceeds from [WCG's] refinancing or remarketing of certain structured notes issued by [WCG] in March 2001 are less than \$1.4 billion. It is anticipated that the ability of [WCG] to pay the notes is dependent on its ability to raise additional capital and its subsidiaries' ability to dividend cash to [WCG]. [WCG], however, is obligated to reimburse Williams for any payment Williams is required to make in connection with these notes. Additionally, receivables include amounts due from [WCG] of approximately \$68.5 million and \$42.8 million at December 31, 2000 and 1999, respectively. Williams has extended the payment term

of up to \$100 million of the outstanding balance due March 31, 2001 to March 15, 2002. Williams is also considering the purchase from [WCG] of the building currently under construction, and would enter into a long-term lease arrangement with [WCG] being the sole occupant of the building.  
Tab 8 of the Appendix, pp. 43-44 of 91.

19. On May 22, 2001 WMB filed an 8-K restating its financial statements for 1998, 1999 and 2000 to reflect the spin-off of WCG. *See* Tab 8 of the Appendix. The restated financials contained the consent of E&Y, dated February 28, 2001, except as to Note 3 for which the date was April 23, 2001. *See id.*, p. 5 of 91. Note 3's relevant language is identical to that set forth in Undisputed Fact 18 immediately above. *See id.*, p. 44 of 91. The WMB 8-K filed May 22, 2001 is incorporated by reference in the Notes Offering Registration Statement, *see* Tab 4 of the Appendix, third unnumbered page, and the Barrett Resources Registration Statement, *see* Tab 3 of the Appendix, pp. 104-105 of 181.

20. In 1999 WCG filed a Registration Statement with the Securities and Exchange Commission (in connection with its initial public offering) in which it disclosed WMB's guarantee concerning the \$750 million Asset Defeasance Program:

#### **ASSET DEFEASANCE PROGRAM**

During 1998, we entered into an asset defeasance program in the form of an operating lease agreement covering a portion of the Williams Network with a group of financial institutions. The total estimated cost of the network assets to be covered by this lease agreement is \$750 million. The lease term will include an interim term, during which the covered network assets will be constructed, which is anticipated to end no later than December 31, 1999, and a base term. The interim and base terms are expected to total five years and, if renewed, could total seven years.

We have an option to purchase the covered network assets during the lease term at an amount approximating the lessor's cost. Williams provides a residual value guarantee equal to a maximum of 89.9% of the transaction. The residual value guarantee is reduced by the present value of the actual lease payments. In the event that we do not exercise the purchase option, we expect the fair market value of the covered network assets to substantially reduce or eliminate Williams' payment under the residual value guarantee. At March 31, 1999, \$368.1 million of construction costs for the Williams Network had been incurred.

Tab 18 of the Appendix, the initial Registration Statement, filed April 9, 1999, p.



109.<sup>1</sup>

21. E&Y was the accountant for WCG in the 1999 WCG IPO and consented to use of its report on WCG's financial statements therein. *Id.*, Exhibit 23.1.

22. Before the spin-off of WCG on April 23, 2001, WMB engaged in a number of financial transactions to prop up WCG:

- (1) guaranteed \$1.4 billion of WCG debt obligations, apart from the \$750 million
- (2) postponed payment of \$100 million of WCG receivables from March 31, 2001 to March 15, 2002
- (3) contributed a WCG promissory note of approximately \$975 million and other assets, including WCG's office building
- (4) left in place the \$750 million guarantee

See Tab 26 of the Appendix.

### III. Legal Standards

The Supreme Court has defined the sweep of Section 11 of the Securities Act of 1933 thus:

Section 11 of the 1933 Act allows purchasers of a registered security to sue certain enumerated parties in a registered offering when false or misleading information is included in a registration statement. The section was designed to assure compliance with the disclosure provision of the act by imposing a stringent standard of liability [FN12] on the parties who \*382 play a direct role in a registered offering. [FN13] If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case. Liability against the issuer of a security is virtually absolute, [FN14] even for innocent misstatements. Other defendants bear the burden of demonstrating due diligence.

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<sup>1</sup> See also Tab 19 of the Appendix, Am. No. 1 to WCG initial IPO Registration Statement, filed May 28, 1999, p. 137; Tab 20 of the Appendix, Am. No. 3 to WCG initial IPO Registration Statement, filed July 12, 1999, p. 144; Tab 21 of the Appendix, Am. No. 4 to WCG initial IPO Registration Statement, filed July 14, 1999, p. 144; Tab 22 of the Appendix, Am. No. 5 to WCG initial IPO Registration Statement, filed July 29, 1999, pp. 144-145; Tab 23 of the Appendix, Am. No. 5 to WCG initial IPO Registration Statement, filed August 18, 1999, p. 147; Tab 24 of the Appendix, Am. No. 9 to WCG initial IPO Registration Statement, filed September 30, 1999, p. 142; Tab 25 of the Appendix, Final Prospectus dated October 1, 1999, filed October 4, 1999, p. 142.

*Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-382 (1983).

Section 11 of the Securities Act imposes liability on every accounting expert consenting to use of its name expertising part of a registration statement filed with the SEC, where the accounting expert's expertised part of the registration statement, when it became effective, "contained an untrue statement of a material fact required to be stated therein or necessary to make the statements therein not misleading...." 15 U.S.C. § 77k(a). Section 11 further provides a defense to E&Y if, after reasonable investigation, it had reasonable ground to believe, and did believe, there were no omissions of material fact required to be stated or necessary to make the statements made not misleading. Liability for Section 11 violations is joint and several. 15 U.S.C. § 77k(f).

The first issue, then, is whether E&Y's failure in the Notes Registration Statement to disclose in Note 3 the existence and terms of WMB's \$750 million guarantee concerning the Asset Defeasance Program is material, as a matter of law. The question of materiality as a matter of law is, *a fortiori*, divided into two parts: materiality, and what is required for a decision as a matter of law.

Materiality, as the Court noted on p. 22 of its order on the WMB Subclass of December 12, 2003, "turns on whether 'a reasonable investor would have considered the matter significant.' 2 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation*, § 12.93[3] (2002)." See also *TSC Industries, Inc. v. Northway, Inc.*, 96 S.Ct. 2126 (1976) ("...there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"). Accord, *Basic Inc. v. Levinson*, 108 S.Ct. 978, 983 (1988)(quoting *TSC Industries*). See also *In re Cendant Corp. Securities Litigation*, 109 F.Supp. 2d 225, 228 (D.N.J. 2000)(granting partial summary judgment for the plaintiff class under Sections 11 and 12 (a)(2)).<sup>2</sup>

The determination of materiality as a matter of law requires a return to *TSC Industries*, where the

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<sup>2</sup> In *Cendant*, as in the case before the Court, "These plaintiffs' securities law claims ... arise from public documents ...." 109 F.Supp.2d at 227.

Supreme Court said:

The issue of materiality may be characterized as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts. In considering whether summary judgment on the issue is appropriate, we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality appropriately resolved "as a matter of law" by summary judgment. *Johns Hopkins University v. Hutton*, 422 F.2d 1124, 1129 (C.A.4 1970). See *Smallwood v. Pearl Brewing Co.*, 489 F.2d, at 604; *Rogen v. Ilikon Corp.*, 361 F.2d 260, 265-267 (C.A.1 1966).

*TSC Industries*, 96 S.Ct. at 2133.

#### IV. Argument

##### A. Application of the Law to the Facts

Had the reasonable investor in the Notes Offering and the Barrett Resources Offering been told of the existence and terms of WMB's \$750 million guarantee of the Asset Defeasance Program (wherein WCG could exercise its purchase option on the Asset Defeasance Program Assets, cause WMB to have to pay the \$750 million purchase price, WMB had to leave the assets with WCG and subordinate its interest to the lenders of WCG's revolving credit facility, and WMB could not collect on the resulting \$750 million debt until one year after the maturity of WCG's revolving credit facility) that disclosure would so obviously have been viewed by the reasonable investor as altering the total mix of information made available in the Notes Offering and the Barrett Resources Offering that reasonable minds cannot differ. As a result, "the ultimate issue of materiality [is] appropriately resolved 'as a matter of law' by summary judgment." *TSC Industries*, 96 S.Ct. at 2133.

The Notes Offering and the Barrett Resources Offerings closed on August 16 and August 2, respectively, 2001. WMB's earnings for 1999 were approximately \$225 million (including a one-time gain of \$65 million), and for 2000 were \$524 million. Thus, \$750 million was more than 300% of 1999 earnings and 150% of 2000 earnings. WMB's earnings for the first three months of 2001



were \$199 million. In this context, the \$750 million guarantee is patently material.

In the first three months of 2001, WCG lost \$306.6 million. On August 1 (the day before the closing of the Barrett Resources Offering), WCG reported losses for the second quarter of 2001 of \$250.1 million. On August 3, 2001 WCG filed an 8-K saying it expected losses in 2001 of \$1.1 billion.

Before the spin-off of WCG on April 23, 2001, WMB engaged in a number of financial transactions to prop up WCG:

1. Guaranteed \$1.4 billion of WCG debt obligations, apart from the \$750 million
2. Postponed payment of \$100 million of WCG receivables from March 31, 2001 to March 15, 2002
3. Contributed a WCG promissory note of approximately \$975 million and other assets, including WCG's office building
4. Left in place the \$750 million guarantee

The option of WCG to cause WMB to have to pay the \$750 million on the \$750 million guarantee, giving WCG the assets and WMB no opportunity to try to collect the \$750 million it paid until one year after the maturity of WCG's revolving credit facility, was so obviously a part of the "total mix" of information a reasonable investor in the Barrett Resources Offering and the Notes Offering would have wanted to know, reasonable minds cannot differ. As counsel for WMB put it so eloquently at the April 25, 2003 hearing, "You want to know facts that are relevant to your investment." Tr., p. 15.

Instead of giving the Barrett Resources Purchasers and the Notes Purchasers the facts concerning the \$750 million guarantee, Note 3 is completely silent on the \$750 million guarantee. Moreover, Note 3 recites a bevy of actions WMB understood to prop up WCG financially: (i) contribution of a \$975 million note; (ii) contribution of a building under construction and other assets; (iii) a \$1.4 billion guarantee; (iv) deferral of up to \$100 million of WCG receivables from March 31, 2001 to March 15, 2002. In addition, Note 3 says WMB was considering buying from WCG the building under construction and leading it back to WCG as the sole tenant. Where in Note 3 was there

reference to the \$750 million Asset Defeasance Program guarantee and its terms? Safely buried in the vault labeled "Material Omissions." In the context of Note 3, disclosure of the existence and terms of the \$750 million Asset Defeasance Program guarantee was necessary to make the statements therein not misleading.

The remainder of the registration statements for the Barrett Resources Offering and the Notes offering do not remove the materiality of Note 3's omission of the existence and terms of the \$750 million guarantee. Indeed, the remainder of each of those documents contains the same material omission:

1. Barrett Resources Registration Statement

**WILLIAMS MAY BE SUBJECT TO LIABILITIES PERTAINING TO ITS SPUN-OFF TELECOMMUNICATIONS BUSINESS UNIT**

In April, 2001, Williams spun off Williams Communications Group, Inc., its telecommunications unit, which was subject to certain lawsuits and settlement negotiations, including claims for damages, indemnification for royalties and other contractual claims by third parties. Further, the unit was subject to a putative class action brought on behalf of all landowners on whose property the plaintiffs have alleged Williams' former telecommunications unit installed fiber-optic cable without the permission of the landowner. Another potential putative class action may challenge the unit's railroad or pipeline rights of way. Williams cannot be certain that this purported class action and other purported class actions against its former telecommunications unit, if successfully brought against Williams, will not have a significant adverse impact on Williams' business. However, in connection with the spin-off, the telecommunications unit agreed to indemnify Williams for all liabilities arising out of the unit's businesses, operations or assets, which should reduce the ultimate impact on Williams.

In addition, Williams is providing indirect credit support for \$1.4 billion of Williams Communications' structured notes through a commitment to issue Williams' equity in the event of a Williams Communications default, or to the extent proceeds from Williams Communications' refinancing or remarketing of certain structured notes prior to March 2004 produces proceeds of less than \$1.4 billion. The ability of Williams Communications to make payments on the notes is dependent on its ability to raise additional capital and its subsidiaries' ability to dividend cash to Williams Communications. Williams Communications, however, is obligated to reimburse Williams for any payment Williams may be required to make in connection with these notes.

Tab 29 of the Appendix (Pages 13-14, WMB Exchange Offer dated July 3, 2001)

2. Notes Registration Statement

**WILLIAMS MAY BE SUBJECT TO LIABILITIES PERTAINING TO ITS SPUN-OFF TELECOMMUNICATIONS BUSINESS UNIT**

In April, 2001, Williams spun off Williams Communications Group, Inc., its telecommunications unit, which was subject to certain lawsuits and settlement negotiations, including claims for damages, indemnification for royalties and other contractual claims by third parties. Further, the unit was subject to a putative class action brought on behalf of all landowners on whose property the plaintiffs have alleged Williams' former telecommunications unit installed fiber-optic cable without the permission of the landowner. Another potential putative class action may challenge the unit's railroad or pipeline rights of way. Williams cannot be certain that this purported class action and other purported class actions against its former telecommunications unit, if successfully brought against Williams, will not have a significant adverse impact on Williams' business. However, in connection with the spin-off, the telecommunications unit agreed to indemnify Williams for all liabilities arising out of the unit's businesses, operations or assets, which should reduce the ultimate impact on Williams.

In addition, Williams is providing indirect credit support for \$1.4 billion of Williams Communications' structured notes through a commitment to issue Williams' equity in the event of a Williams Communications default, or to the extent proceeds from Williams Communications' refinancing or remarketing of certain structured notes prior to March 2004 produces proceeds of less than \$1.4 billion. The ability of Williams Communications to make payments on the notes is dependent on its ability to raise additional capital and its subsidiaries' ability to dividend cash to Williams Communications. Williams Communications, however, is obligated to reimburse Williams for any payment Williams may be required to make in connection with these notes.

Tab 28 of the Appendix (Page S-4, August 16, 2001 Prospectus Supplement).

Thus, Note 3's omission of the \$750 million Asset Defeasance Program guarantee so obviously affected the total mix of information about WMB that reasonable minds cannot differ.

**B. WMB's Specious "Comeback"**

The Court will recall that at the hearing on the motions to dismiss, counsel for WMB defended the omission of the \$750 million Asset Defeasance Program guarantee by asserting WMB made disclosure thereof by incorporating by reference the 1999 and 2000 WMB 10-Ks<sup>3</sup>. This assertion is

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<sup>3</sup> Counsel incorrectly asserted the 1999 10-K was incorporated by reference. It was not. See Tab 4 of the Appendix, the third unnumbered page, "Incorporation of Certain Documents by

as inapplicable to E&Y as it is to WMB, for the following reasons. *First*. The omission in Note 3 is material in the context of Note 3, which is the applicable test. *Second*. The remainder of the registration statements make the same material omission in context, in the section headlined "Williams May Be Subject to Liabilities Pertaining to its Spin-Off Telecommunications Unit." *Third*. The 2000 10-K was superseded by WMB's 8-K filed May 22, 2001, which (a) restated WMB's financial statements for 1998, 1999 and 2000 to reflect the spin-off of WCG, (b) contained the consent of E&Y, saying the effective date of its report was February 28, 2001 except for Note 3, the date of which was April 23, 2001, and (c) contained virtually the same Note 3 as appears in the Notes Offering Registration Statement and the Barrett Resources Registration Statement, which Note 3 is completely silent about WMB's \$750 million guarantee of the Asset Defeasance Program. See Tab 8 of the Appendix. *Fourth*. The 2000 10-K is not effective past the date of its filing, which was March 12, 2001. *Fifth*. The 2000 10-K is replete with references to WCG, but the "disclosure" of the \$750 million guarantee does not refer to WCG, but to "Williams":

During 1998, Williams entered into an operating lease agreement covering a portion of its fiber-optic network. The total cost of the network assets covered by the lease agreement was \$750 million. The lease terms are expected to total five years and, if renewed, could total seven years. Under the terms of the lease agreement, Williams cannot sublease the assets without the prior written consent of the lessor. Through December 31, 2000, Williams has not requested nor has the lessor granted such consent.

Williams has an option to purchase the covered network assets during the lease term at an amount approximating the lessor's cost. Williams provides a residual value guarantee equal to a maximum of 89.9 percent of the transaction. The residual value guarantee is reduced by the present value of actual lease payments. In the event that Williams does not exercise its purchase option, Williams expects the fair market value of the covered network assets to substantially reduce Williams' obligation under the residual value guarantee. Williams' disclosures for future minimum annual rentals under noncancellable operating leases do not include amounts for the residual value guarantee.

Tab 7 of the Appendix, p. 86.

*Sixth*. Even if a reader of the 2000 10-K concluded the discussion of the "Williams" \$750 million

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Reference."



guarantee was a guarantee of WCG, the absence of any reference to same in Note 3 and in the restated WMB financials filed with the consent of E&Y on May 22, 2001 in WMB's 8-K, necessarily means there is no longer any such guarantee. This conclusion follows logically and because the reasonable investor knows of the strict legal requirements of Section 11. *Seventh.* The 2000 10-K is not the only document incorporated by reference. So is the May 15, 2001 10-Q of WMB, Tab 9 of the Appendix. There, WMB outlines in great detail its exposure to WCG, without any reference whatever to the \$750 million Asset Defeasance Program guarantee (thus further demonstrating that whatever obtained in the March 12, 2001 filed 10-K no longer obtains):

Williams, prior to the spin-off and in an effort to strengthen WCG's capital structure, entered into an agreement under which Williams contributed an outstanding promissory note from WCG of approximately \$975 million and certain other assets, including a building under construction. In return, Williams received 24.3 million newly issued common shares of WCG. Williams is also providing indirect credit support through a commitment to issue Williams' equity in the event of a WCG default, or to the extent proceeds from WCG's refinancing or remarketing of certain structured notes issued by WCG in March 2001 are less than \$1.4 billion. It is anticipated that the ability of WCG to pay the notes is dependent on its ability to raise additional capital and its subsidiaries' ability to dividend cash to WCG. WCG, however, is obligated to reimburse Williams for any payment Williams is required to make in connection with these notes. Additionally, receivables include amounts due from WCG of approximately \$111 million and \$69 million at March 31, 2001 and December 31, 2000, respectively. Williams has extended the payment term of up to \$100 million of the outstanding balance due March 31, 2001 to March 15, 2002. Williams is also considering the purchase from WCG of the building currently under construction, and would enter into a long-term lease arrangement with WCG being the sole occupant of the building.

Tab 26 of the Appendix.

*Eighth.* The Notes Registration Statement also incorporates by reference WMB's second quarter 2001 10-Q, filed August 13, 2001. There, the copious disclosure of other exposure to WCG-related guarantees and financial obligations is, again, completely silent about the existence and terms of the \$750 million Asset Defeasance Program guarantee:

Williams is providing indirect credit support for \$1.4 billion of WCG's structured notes through a commitment to issue Williams' equity in the event of WCG's default, or to the extent proceeds from WCG's refinancing or remarketing of certain structured notes prior to March 2004 produces proceeds of less than \$1.4 billion. The ability of



WCG to make payments on the notes is dependent on its ability to raise additional capital and its subsidiaries' ability to dividend cash to WCG. WCG however, is obligated to reimburse Williams for any payment Williams is required to make in connection with these notes. Williams is also considering the purchase from WCG of its headquarters building currently under construction, and would enter into a long-term lease arrangement with WCG being the sole occupant of the building. See Tab 33 of the Appendix.

Thus, from May through the August 16, 2001 closing of the Notes Offering, WMB, the named Individual Defendants, E&Y, and Merrill Lynch, Salomon Smith Barney and Lehman Brothers maintained "radio silence." *Ninth*. The 2000 10-K discussion cannot even begin to be considered a part of the context of Note 3 in the absence of any cross-reference in Note 3. *Tenth*. Even if there had been such a cross-reference, Note 3 would still be materially misleading because the following disclosure (made in the FELINE PACs Registration Statement) was required in order to keep Note 3 from being materially misleading:

Williams has provided a guarantee of Williams Communications' obligations under a 1998 transaction in which Williams Communications entered into an operating lease agreement covering a portion of its fiber-optic network. The total cost of the network assets covered by the lease agreement is \$750 million. The lease terms initially totaled five years and, if renewed, could extend to seven years. Williams Communications has an option to purchase the covered network assets during the lease term at an amount approximating lessor's cost. As a result of an agreement between Williams and Williams Communications' revolving credit facility lenders, if Williams gains control of the network assets covered by the lease, Williams is obligated to return the assets to Williams Communications for such property must be subordinated to the interests of Williams Communications' revolving credit facility lenders and may not mature any earlier than one year after the maturity of Williams Communications' revolving credit facility. Tab 30 of the Appendix.

Thus, the "comeback" is a non-starter.

### **C. The Due Diligence Defense**

E&Y has been WMB's auditor for many years. E&Y issued its report on WMB's financial statements for 1999 and 2000. The 2000 financials refer to a \$750 million guarantee on fiber-optic network assets of "Williams." E&Y consented to usage of its report on WMB's 1999 financials in

the January 2001 Stock Offering.<sup>4</sup> WMB's financial condition in 1999 included the existence of the \$750 million Asset Defeasance Program, and WMB's guarantee. E&Y consented to usage of its report on WMB's 2000 financials in the Barrett Resources Offering and the Notes Offering. The consents specifically stated that the date of E&Y's report was February 28, 2001, except for Note 3, as to which the date was April 23, 2001. Note 3 outlined in detail WMB's exposure to WCG, except for the \$750 million guarantee which E&Y previously knew about. Thus, E&Y could, through reasonable investigation, have known of its material omission in Note 3 of the \$750 million guarantee.

#### **V. Conclusion**

Partial summary judgment should be entered against Ernst & Young as to its joint and several liability (with damages to be determined at a later time) to those members of the Subclass who purchased or can trace their purchase of Notes to the Notes Offering or the Barrett Resources Offering, for violation of Section 11 of the Securities Act of 1933, by materially omitting to disclose in Note 3 used in the Notes Offering and the Barrett Resources Offering the existence and terms of WMB's \$750 million guarantee concerning the Asset Defeasance Program.

Respectfully submitted,

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<sup>4</sup> It is not necessary for the Court to include in its decision Undisputed Fact 21, which is that E&Y was the auditor for WCG in its IPO, which IPO disclosed the \$750 million guarantee. This fact provides a separate ground to show, as a matter of law, what a reasonable investigation would have revealed to E&Y.



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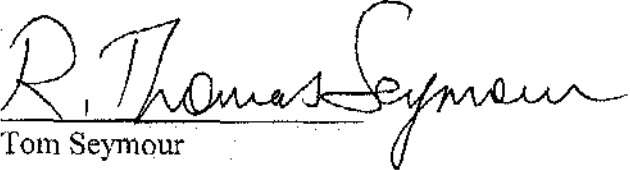
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**CERTIFICATE OF SERVICE**

I the undersigned do hereby certify that on the 2<sup>nd</sup> day of April, 2004, a true and correct copy of the above and foregoing was mailed to the counsel of record listed in the following service list attached hereto:

  
Tom Seymour

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