

fWorldCom¹

By Dennis Moberg (Santa Clara University) and Edward Romar (University of Massachusetts-Boston)

An **update** for this case is available.

2002 saw an unprecedented number of corporate scandals: Enron, Tyco, Global Crossing. In many ways, WorldCom is just another case of failed corporate governance, accounting abuses, and outright greed. But none of these other companies had senior executives as colorful and likable as Bernie Ebbers. A Canadian by birth, the 6 foot, 3 inch former basketball coach and Sunday School teacher emerged from the collapse of WorldCom not only broke but with a personal net worth as a negative nine-digit number.² No palace in a gated community, no stable of racehorses or multi-million dollar yacht to show for the telecommunications giant he created. Only debts and red ink--results some consider inevitable given his unflagging enthusiasm and entrepreneurial flair. There is no question that he did some pretty bad stuff, but he really wasn't like the corporate villains of his day: Andy Fastow of Enron, Dennis Koslowski of Tyco, or Gary Winnick of Global Crossing.³

Personally, Bernie is a hard guy not to like. In 1998 when Bernie was in the midst of acquiring the telecommunications firm MCI, Reverend Jesse Jackson, speaking at an all-black college near WorldCom's Mississippi headquarters, asked how Ebbers could afford \$35 billion for MCI but hadn't donated funds to local black students. Businessman LeRoy Walker Jr., was in the audience at Jackson's speech, and afterwards set him straight. Ebbers had given over \$1 million plus loads of information technology to that black college. "Bernie Ebbers," Walker reportedly told Jackson, "is my mentor."⁴ Rev. Jackson was won over, but who wouldn't be by this erstwhile milkman and bar bouncer who serves meals to the homeless at Frank's Famous Biscuits in downtown Jackson, Mississippi, and wears jeans, cowboy boots, and a funky turquoise watch to work.

It was 1983 in a coffee shop in Hattiesburg, Mississippi that Mr. Ebbers first helped create the business concept that would become WorldCom. "Who could have thought that a small business in itty bitty Mississippi would one day rival AT&T?" asked an editorial in Jackson, Mississippi's Clarion-Ledger newspaper.⁵ Bernie's fall-and the company's-was abrupt. In June 1999 with WorldCom's shares trading at \$64, he was a billionaire,⁶ and WorldCom was the darling of the New Economy. By early May of 2002, Ebbers resigned his post as CEO, declaring that he was "1,000 percent convinced in my heart that this is a temporary thing."⁷ Two months later, in spite of Bernie's unflagging optimism, WorldCom declared itself the largest bankruptcy in American history.⁸

This case describes three major issues in the fall of WorldCom: the corporate strategy of growth through acquisition, the use of loans to senior executives, and threats to corporate governance created by chumminess and lack of arm's-length dealing. The case concludes with a brief description of the hero of the case-whistle blower Cynthia Cooper.

The Growth Through Acquisition Merry-Go-Round

From its humble beginnings as an obscure long distance telephone company WorldCom, through the execution of an aggressive acquisition strategy, evolved into the second-largest long distance telephone company in the United States and one of the largest companies handling worldwide Internet data traffic.⁹ According to the WorldCom Web site, at its high point, the company

- Provided mission-critical communications services for tens of thousands of businesses around the world

- Carried more international voice traffic than any other company
- Carried a significant amount of the world's Internet traffic
- Owned and operated a global IP (Internet Protocol) backbone that provided connectivity in more than 2,600 cities and in more than 100 countries
- Owned and operated 75 data centers...on five continents. [Data centers provide hosting and allocation services to businesses for their mission-critical business computer applications.]¹⁰

WorldCom achieved its position as a significant player in the telecommunications industry through the successful completion of 65 acquisitions.¹¹ Between 1991 and 1997, WorldCom spent almost \$60 billion in the acquisition of many of these companies and accumulated \$41 billion in debt.¹² Two of these acquisitions were particularly significant. The MFS Communications acquisition enabled WorldCom to obtain UUNet, a major supplier of Internet services to business, and MCI Communications gave WorldCom one of the largest providers of business and consumer telephone service. By 1997, WorldCom's stock had risen from pennies per share to over \$60 a share.¹³ Through what appeared to be a prescient and successful business strategy at the height of the Internet boom, WorldCom became a darling of Wall Street. In the heady days of the technology bubble Wall Street took notice of WorldCom and its then visionary CEO, Bernie Ebbers. This was a company "on the move," and Wall Street investment banks, analysts and brokers began to discover WorldCom's value and make "strong buy recommendations" to investors.

As this process began to unfold, the analysts' recommendations, coupled with the continued rise of the stock market, made WorldCom stock desirable, and the market's view of the stock was that it could only go up. As the stock value went up, it was easier for WorldCom to use stock as the vehicle to continue to purchase additional companies. The acquisition of MFS Communications and MCI Communications were, perhaps, the most significant in the long list of WorldCom acquisitions. With the acquisition of MFS Communications and its UUNet unit, "WorldCom (s)uddenly had an investment story to offer about the value of combining long distance, local service and data communications."¹⁴ In late 1997, British Telecommunications Corporation made a \$19 billion bid for MCI. Very quickly, Ebbers made a counter offer of \$30 billion in WorldCom stock. In addition, Ebbers agreed to assume \$5 billion in MCI debt, making the deal \$35 billion or 1.8 times the value of the British Telecom offer. MCI took WorldCom's offer making WorldCom a truly significant global telecommunications company.¹⁵

All this would be just another story of a successful growth strategy if it weren't for one significant business reality--mergers and acquisitions, especially large ones, present significant managerial challenges in at least two areas. First, management must deal with the challenge of integrating new and old organizations into a single smoothly functioning business. This is a time-consuming process that involves thoughtful planning and considerable senior managerial attention if the acquisition process is to increase the value of the firm to both shareholders and stakeholders. With 65 acquisitions in six years and several of them large ones, WorldCom management had a great deal on their plate. The second challenge is the requirement to account for the financial aspects of the acquisition. The complete financial integration of the acquired company must be accomplished, including an accounting of assets, debts, good will and a host of other financially important factors. This must be accomplished through the application of generally accepted accounting practices (GAAP).

WorldCom's efforts to integrate MCI illustrate several areas senior management did not address well. In the first place, Ebbers appeared to be an indifferent executive who "paid scant attention to the details of operations."¹⁶; For example, customer service deteriorated. One business customer's service was discontinued incorrectly, and when the customer contacted customer service, he was told he was not a customer. Ultimately, the WorldCom representative told him that if he was a customer, he had called the wrong office because the office he called only handled MCI accounts.¹⁷ This poor customer stumbled "across a problem stemming from WorldCom's acquisition binge: For all its talent in buying competitors, the

company was not up to the task of merging them. Dozens of conflicting computer systems remained, local systems were repetitive and failed to work together properly, and billing systems were not coordinated."¹⁸ Poor integration of acquired companies also resulted in numerous organizational problems. Among them were:

- Senior management made little effort to develop a cooperative mindset among the various units of WorldCom.
- Inter-unit struggles were allowed to undermine the development of a unified service delivery network.
- WorldCom closed three important MCI technical service centers that contributed to network maintenance only to open twelve different centers that, in the words of one engineer, were duplicate and inefficient.
- Competitive local exchange carriers (Clercs) were another managerial nightmare. WorldCom purchased a large number of these to provide local service. According to one executive, "(t)he WorldCom model was a vast wasteland of Clercs, and all capacity was expensive and very underutilized...There was far too much redundancy, and we paid far too much to get it."¹⁹

Regarding financial reporting, WorldCom used a liberal interpretation of accounting rules when preparing financial statements. In an effort to make it appear that profits were increasing, WorldCom would write down in one quarter millions of dollars in assets it acquired while, at the same time, it "included in this charge against earnings the cost of company expenses expected in the future. The result was bigger losses in the current quarter but smaller ones in future quarters, so that its profit picture would seem to be improving."²⁰ The acquisition of MCI gave WorldCom another accounting opportunity. While reducing the book value of some MCI assets by several billion dollars, the company increased the value of "good will," that is, intangible assets—a brand name, for example—by the same amount. This enabled WorldCom each year to charge a smaller amount against earnings by spreading these large expenses over decades rather than years. The net result was WorldCom's ability to cut annual expenses, acknowledge all MCI revenue and boost profits from the acquisition.

WorldCom managers also tweaked their assumptions about accounts receivables, the amount of money customers owe the company. For a considerable time period, management chose to ignore credit department lists of customers who had not paid their bills and were unlikely to do so. In this area, managerial assumptions play two important roles in receivables accounting. In the first place, they contribute to the amount of funds reserved to cover bad debts. The lower the assumption of non-collectable bills, the smaller the reserve fund required. The result is higher earnings. Secondly, if a company sells receivables to a third party, which WorldCom did, then the assumptions contribute to the amount or receivables available for sale.²¹

So long as there were acquisition targets available, the merry-go-round kept turning, and WorldCom could continue these practices. The stock price was high, and accounting practices allowed the company to maximize the financial advantages of the acquisitions while minimizing the negative aspects. WorldCom and Wall Street could ignore the consolidation issues because the new acquisitions allowed management to focus on the behavior so welcome by everyone, the continued rise in the share price. All this was put in jeopardy when, in 2000, the government refused to allow WorldCom's acquisition of Sprint. The denial stopped the carousel, put an end to WorldCom's acquisition-without-consolidation strategy and left management a stark choice between focusing on creating value from the previous acquisitions with the possible loss of share value or trying to find other creative ways to sustain and increase the share price.

In July 2002, WorldCom filed for bankruptcy protection after several disclosures regarding accounting irregularities. Among them was the admission of improperly accounting for operating expenses as capital

expenses in violation of generally accepted accounting practices (GAAP). WorldCom has admitted to a \$9 billion adjustment for the period from 1999 through the first quarter of 2002.

Sweetheart Loans To Senior Executives

Bernie Ebbers' passion for his corporate creation loaded him up on common stock. Through generous stock options and purchases, Ebbers' WorldCom holdings grew and grew, and he typically financed these purchases with his existing holdings as collateral. This was not a problem until the value of WorldCom stock declined, and Bernie faced margin calls (a demand to put up more collateral for outstanding loans) on some of his purchases. At that point he faced a difficult dilemma. Because his personal assets were insufficient to meet the call, he could either sell some of his common shares to finance the margin calls or request a loan from the company to cover the calls. Yet, when the board learned of his problem, it refused to let him sell his shares on the grounds that it would depress the stock price and signal a lack of confidence about WorldCom's future.²²

Had he pressed the matter and sold his stock, he would have escaped the bankruptcy financially whole, but Ebbers honestly thought WorldCom would recover. Thus, it was enthusiasm and not greed that trapped Mr. Ebbers. The executives associated with other corporate scandals sold at the top. In fact, other WorldCom executives did much, much better than Ebbers did.²³ Bernie borrowed against his stock. That course of action makes sense if you believe the stock will go up, but it's the road to ruin if the stock goes down. Unlike the others, he intended to make himself rich taking the rest of the shareholders with him. In his entire career, Mr. Ebbers sold company shares only half a dozen times. Detractors may find him irascible and arrogant, but defenders describe him as a principled man.²⁴

The policy of boards of directors authorizing loans for senior executives raises eyebrows. The sheer magnitude of the loans to Ebbers was breathtaking. The \$341 million loan the board granted Mr. Ebbers is the largest amount any publicly traded company has lent to one of its officers in recent memory.²⁵ Beyond that, some question whether such loans are ethical. "A large loan to a senior executive epitomizes concerns about conflict of interest and breach of fiduciary duty," said former SEC enforcement official Seth Taube.²⁶ Nevertheless, 27percent of major publicly traded companies had loans outstanding for executive officers in 2000 up from 17percent in 1998 (most commonly for stock purchase but also home buying and relocation). Moreover, there is the claim that executive loans are commonly sweetheart deals involving interest rates that constitute a poor return on company assets. WorldCom charged Ebbers slightly more than 2percent interest, a rate considerably below that available to "average" borrowers and also below the company's marginal rate of return. Considering such factors, one compensation analyst claims that such lending "should not be part of the general pay scheme of perks for executives...I just think it's the wrong thing to do."²⁷

What's a Nod or Wink Among Friends?

In the autumn of 1998, Securities and Exchange Commission Chairman Arthur Levitt Jr. uttered the prescient criticism, "Auditors and analysts are participants in a game of nods and winks."²⁸ It should come as no surprise that it was Arthur Andersen that endorsed many of the accounting irregularities that contributed to WorldCom's demise.²⁹ Beyond that, however, were a host of incredibly chummy relationships between WorldCom's management and Wall Street analysts.

Since the Glass-Steagall Act was repealed in 1999, financial institutions have been free to offer an almost limitless range of financial services to their commercial and investment clients. Citigroup, the result of the merger of Citibank and Travelers Insurance Company, which owned the investment bank and brokerage firm Solomon Smith Barney, was an early beneficiary of investment deregulation. Citibank regularly dispensed

cheap loans and lines of credit as a means of attracting and rewarding corporate clients for highly lucrative work in mergers and acquisitions. Since WorldCom was so active in that mode, their senior managers were the targets of a great deal of influence peddling by their banker, Citibank. For example, Travelers Insurance, a Citigroup unit, lent \$134 million to a timber company Bernie Ebbers was heavily invested in. Eight months later, WorldCom chose Salomon Smith Barney, Citigroup's brokerage unit, to be the lead underwriter of \$5 billion of its bond issue.³⁰

But the entanglements went both ways. Since the loan to Ebbers was collateralized by his equity holdings, Citigroup had reason to prop up WorldCom stock. And no one was better at that than Jack Grubman, Salomon Smith Barney's telecommunication analyst. Grubman first met Bernie Ebbers in the early 1990s when he was heading up the precursor to WorldCom, LDDS Communications. The two hit it off socially, and Grubman started hyping the company. Investors were handsomely rewarded for following Grubman's buy recommendations until stock reached its high, and Grubman rose financially and by reputation. In fact, *Institutional Investing* magazine gave Jack a Number 1 ranking in 1999,³¹ and *Business Week* labeled him "one of the most powerful players on Wall Street."³²

The investor community has always been ambivalent about the relationship between analysts and the companies they analyze. As long as analyst recommendations are correct, close relations have a positive insider quality, but when their recommendations turn sour, corruption is suspected. Certainly Grubman did everything he could to tout his personal relationship with Bernie Ebbers. He bragged about attending Bernie's wedding in 1999. He attended board meeting at WorldCom's headquarters. Analysts at competing firms were annoyed with this chumminess. While the other analysts strained to glimpse any tidbit of information from the company's conference call, Grubman would monopolize the conversation with comments about "dinner last night."³³

It is not known who picked up the tab for such dinners, but Grubman certainly rewarded executives for their close relationship with him.³⁴ Both Ebbers and WorldCom CFO Scott Sullivan were granted privileged allocations in IPO (Initial Public Offering) auctions. While the Securities and Exchange Commission allows underwriters like Salomon Smith Barney to distribute their allotment of new securities as they see fit among their customers, this sort of favoritism has angered many small investors. Banks defend this practice by contending that providing high-net-worth individuals with favored access to hot IPOs is just good business.³⁵ Alternatively, they allege that greasing the palms of distinguished investors creates a marketing "buzz" around an IPO, helping deserving small companies trying to go public get the market attention they deserve.³⁶ For the record, Mr. Ebbers personally made \$11 million in trading profits over a four-year period on shares from initial public offerings he received from Salomon Smith Barney.³⁷ In contrast, Mr. Sullivan lost \$13,000 from IPOs, indicating that they were apparently not "sure things."³⁸

There is little question but that friendly relations between Grubman and WorldCom helped investors from 1995 to 1999. Many trusted Grubman's insider status and followed his rosy recommendations to financial success. In a 2000 profile in *Business Week*, he seemed to mock the ethical norm against conflict of interest: "What used to be a conflict is now a synergy," he said at the time. "Someone like me...would have been looked at disdainfully by the buy side 15 years ago. Now they know that I'm in the flow of what's going on."³⁹ Yet, when the stock started cratering later that year, Grubman's enthusiasm for WorldCom persisted. Indeed, he maintained the highest rating on WorldCom until March 18, 2002, when he finally raised its risk rating. At that time, the stock had fallen almost 90 percent from its high two years before. Grubman's *mea culpa* to clients on April 22 read, "In retrospect the depth and length of the decline in enterprise spending has been stronger and more damaging to WorldCom than we even anticipated."⁴⁰ An official statement from Salomon Smith Barney two weeks later seemed to contradict the notion that Grubman's analysis was conflicted: "Mr. Grubman was not alone in his enthusiasm for the future prospects of the company. His

coverage was based purely on information yielded during his analysis and was not based on personal relationships."⁴¹ Right.

On August 15, 2002, Jack Grubman resigned from Salomon where he had made as much as \$20 million/year. His resignation letter read in part, "I understand the disappointment and anger felt by investors as a result of [the company's] collapse, I am nevertheless proud of the work I and the analysts who work with me did."⁴² On December 19, 2002, Jack Grubman was fined \$15 million and was banned from securities transactions for life by the Securities and Exchange Commission for such conflicts of interest. The media vilification that accompanies one's fall from power unearthed one interesting detail about Grubman's character—he repeated lied about his personal background. A graduate of Boston University, Mr. Grubman claimed a degree from MIT. Moreover, he claimed to have grown up in colorful South Boston, while his roots were actually in Boston's comparatively bland Oxford Circle neighborhood.⁴³ What makes a person fib about his personal history is an open question. As it turns out, this is probably the least of Jack Grubman's present worries. New York State Controller H. Carl McCall sued Citicorp, Arthur Andersen, Jack Grubman, and others for conflict of interest. According to Mr. McCall, "This is another case of corporate coziness costing investors billions of dollars and raising troubling questions about the integrity of the information investors receive."⁴⁴

The Hero of the Case

No integrity questions can be raised about Cynthia Cooper whose careful detective work as an internal auditor at WorldCom exposed some of the accounting irregularities apparently intended to deceive investors. Originally assigned responsibilities in operational auditing, Cynthia and her colleagues grew suspicious of a number of peculiar financial transactions and went outside their assigned responsibilities to investigate. What they found was a series of clever manipulations intended to bury almost \$4 billion in misallocated expenses and phony accounting entries.⁴⁵

A native of Clinton, Mississippi, where WorldCom's headquarters was located, Ms. Cooper conducted her detective work in secret, often late at night to avoid suspicion. The thing that first aroused her curiosity came in March 2002 when a senior line manager complained to her that her boss, CFO Scott Sullivan, had usurped a \$400 million reserve account he had set aside as a hedge against anticipated revenue losses. That didn't seem kosher, so Cooper inquired of WorldCom's accounting firm, Arthur Andersen. They brushed her off, and Ms. Cooper decided to press the matter with the board's audit committee. That put her in direct conflict with her boss, Sullivan, who ultimately backed down. The next day, however, he warned her to stay out of such matters.

Undeterred and emboldened by the knowledge that Andersen had been discredited by the Enron case and that the SEC was investigating WorldCom, Cynthia decided to continue her investigation. Along the way, she learned of a WorldCom financial analyst who was fired a year earlier for failing to go along with accounting chicanery.⁴⁶ Ultimately, she and her team uncovered a \$2 billion accounting entry for capital expenditures that had never been authorized. It appeared that the company was attempting to represent operating costs as capital expenditures in order to make the company look more profitable. To gather further evidence, Cynthia's team began an unauthorized search through WorldCom's computerized accounting information system. What they found was evidence that fraud was being committed. When Sullivan heard of the ongoing audit, he asked Cooper to delay her work until the third quarter. She bravely declined. She went to the board's audit committee and in June, Scott Sullivan and two others were terminated. What Ms. Cooper had discovered was the largest accounting fraud in U.S. history.⁴⁷

As single-minded as Cynthia Cooper appeared during this entire affair, it was an incredibly trying ordeal. Her parents and friends noticed that she was under considerable stress and was losing weight. According to the Wall Street Journal, she and her colleagues worried "that their findings would be devastating to the

company [and] whether their revelations would result in layoffs and obsessed about whether they were jumping to unwarranted conclusions that their colleagues at WorldCom were committing fraud. Plus, they feared that they would somehow end up being blamed for the mess."⁴⁸

It is unclear at this writing whether Bernie Ebbers will be held responsible for the accounting irregularities that brought down his second in command. Jack Grubman's final legal fate is also unclear. While the ethical quality of enthusiasm and sociability are debatable, the virtue of courage is universally acclaimed, and Cynthia Cooper apparently has it. Thus, it was not surprising that on December 21, 2002, Cynthia Cooper was recognized as one of three "Persons of the Year" by Time magazine.

Questions For Discussion

1. What are the ethical considerations involved in a company's decision to loan executives money to cover margin calls on their purchase of shares of company stock?
2. When well conceived and executed properly, a growth-through-acquisition strategy is an accepted method to grow a business. What went wrong at WorldCom? Is there a need to put in place protections to insure stakeholders benefit from this strategy? If so, what form should these protections take?
3. What are the ethical pros and cons of a banking firm giving their special clients privileged standing in "hot" IPO auctions?
4. Jack Grubman apparently lied in his official biography at Salomon Smith Barney. Isn't this simply part of the necessary role of marketing yourself? Is it useful to distinguish between "lying" and merely "fudging"?
5. Cynthia Cooper and her colleagues worried about their revelations bringing down the company. Her boss, Scott Sullivan, asked her to delay reporting her findings for one quarter. She and her team did not know for certain whether this additional time period might have given Sullivan time to "save the company" from bankruptcy. Assume that you were a member of Cooper's team and role-play this decision-making situation.

Footnotes

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WorldCom Case Study Update 2006¹

by **Edward J. Romar, University of Massachusetts-Boston, and Martin Calkins, University of Massachusetts-Boston**

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In December 2005, two years after this case was written, the telecommunications industry consolidated further. Verizon Communications acquired MCI/WorldCom and SBC Communications acquired AT&T Corporation, which had been in business since the 19th Century. The acquisition of MCI/WorldCom was the direct result of the behavior of WorldCom's senior managers as documented above. While it can be argued that the demise of AT&T Corp. was not wholly attributable to WorldCom's behavior, AT&T Corp.'s decimation certainly was facilitated by the events surrounding WorldCom, since WorldCom was the benchmark long distance telephone and Internet communications service provider. Indeed, the ripple effect of WorldCom's demise goes far beyond one company and several senior managers. It had a profound effect on an entire industry.

This postscript will update the WorldCom story by focusing on what happened to the company after it declared bankruptcy and before it was acquired by Verizon. The postscript also will relate subsequent important events in the telecommunications industry, the effect of WorldCom's problems on its competitors and labor market, and the impact WorldCom had on the lives of the key players associated with the fraud and its exposure.

From Benchmark to Bankrupt

Between July 2002 when WorldCom declared bankruptcy and April 2004 when it emerged from bankruptcy as MCI, company officials worked feverishly to restate the financials and reorganize the company. The new CEO Michael Capellas (formerly CEO of Compaq Computer) and the newly appointed CFO Robert Blakely faced the daunting task of settling the company's outstanding debt of around \$35 billion and performing a rigorous financial audit of the company. This was a monumental task, at one point utilizing an army of over 500 WorldCom employees, over 200 employees of the company's outside auditor, KPMG, and a supplemental workforce of almost 600 people from Deloitte & Touch. As Joseph McCafferty notes, "(a)t the peak of the audit, in late 2003, WorldCom had about 1,500 people working on the restatement, under the combined management of Blakely and five controllers...(the t)otal cost to complete it: a mind-blowing \$365 million"(McCafferty, 2004).

In addition to revealing sloppy and fraudulent bookkeeping, the post-bankruptcy audit found two important new pieces of information that only served to increase the amount of fraud at WorldCom. First, "WorldCom had overvalued several acquisitions by a total of \$5.8 billion"(McCafferty, 2004). In addition, Sullivan and Ebbers, "had claimed a pretax profit for 2000 of \$7.6 billion" (McCafferty, 2004). In reality, WorldCom lost "\$48.9 billion (including a \$47 billion write-down of impaired assets)." Consequently, instead of a \$10 billion profit for the years 2000 and 2001, WorldCom had a combined loss for the years 2000 through 2002 (the year it declared bankruptcy) of \$73.7 billion. If the \$5.8 billion of overvalued assets is added to this figure, the total fraud at WorldCom amounted to a staggering \$79.5 billion.

Although the newly audited financial statements exposed the impact of the WorldCom fraud on the company's shareholders, creditors, and other stakeholders, other information made public since 2002 revealed the effects of the fraud on the company's competitors and the telecommunications industry as a whole. These show that the fall of WorldCom altered the fortunes of a number of telecommunications industry participants, none more so than AT&T Corporation.

The CNBC news show, "The Big Lie: Inside the Rise and Fraud of WorldCom," exposed the extent of the WorldCom fraud on several key participants, including the then-chairmen of AT&T and Sprint (Faber, 2003). The so-called "big lie" was promoted through a spreadsheet developed by Tom Stluka, a capacity planner at WorldCom, that modeled in Excel format the amount of traffic WorldCom could expect in a best-case scenario of Internet growth. In essence, "Stluka's model suggested that in the best of all possible worlds Internet traffic would double every 100 days" (Faber, 2003). In working with the model, Stluka simply assigned variables with various parameters to "whatever we think is appropriate"(Faber, 2003).

This was innocent enough, had it remained an exercise. A problem emerged when the exercise was extended and integrated into corporate strategy, when it was adopted and implemented by WorldCom and then by the telecommunications industry. Within a year, "other companies were touting it" and the model was given credibility it should not have been accorded (Faber, 2003). As Stluka explains, "there were a lot of people who were saying 10X growth, doubling every three to four months, doubling every 100 days, 1,000 percent, that kind of thing" (Faber, 2003).

But it wasn't true. "I don't recall traffic ... in fact growing at that rate ... still, WorldCom's lie had become an immutable law." Optimistic scenarios with little foundation in reality began to spread and pervade the industry. They became emblematic of the "smoke and mirrors" behavior not only at WorldCom prior to its collapse, but the industry as a whole.

Fictitious numbers drove not just WorldCom, but also other companies as they reacted to WorldCom's optimistic projections. According to Michael Armstrong, then chairman and CEO of AT&T, "For some period of time, I can recall that we were back-filling that expectation with laying cable, something like 2,200 miles of cable an hour" (Faber, 2003). He adds: "Think of all the companies that went out of business that assumed that that was real."

The fallout from the WorldCom debacle was significant. Verizon obtained the freshly minted MCI for \$7.6 billion, but not the \$35 billion of debt MCI had when it declared bankruptcy (Alexander, 2005). Although WorldCom was one of the largest telecommunications companies with nearly \$160 billion in assets, shareholder suits obtained \$6.1 billion from a variety of sources including investment banks, former board members and auditors of WorldCom (Belson, 2005). If this sum were evenly distributed among the firm's 2.968 billion common shares, the payoff would (have been) well under \$1 a share for a stock that peaked at \$49.91 on Jan. 2000" (Alexander, 2005, 3).

There are more losers in the aftermath of the WorldCom wreck. The reemerged MCI was left with about 55,000 employees, down from 88,000 at its peak. Since March 2001, however, "about 300,000 telecommunications workers have lost their jobs. The sector's total employment-1.032 million-is at an eight year low" (Alexander, 2005, 3). The carnage does not stop there. Telecommunications equipment manufacturers such as Lucent Technologies, Nortell Networks, and Corning, while benefiting initially from WorldCom's groundless predictions, suffered in the end with layoffs and depressed share prices. Perhaps most significant, in December 2005, the venerable AT&T Corporation ceased to exist as an independent company.

The Impact on Individuals

The WorldCom fiasco had a permanent effect on the lives of its key players as well. Cynthia Cooper, who spearheaded the uncovering of the fraud, went on to become one of Time Magazine's 2002 Persons of the Year. She also received a number of awards, including the 2003 Accounting Exemplar Award, given to an individual who has made notable contributions to professionalism and ethics in accounting practice or education. At present, she travels extensively, speaking to students and professionals about the importance of strong ethical and moral leadership in business (Nationwide Speakers Bureau, 2004). Even so, as Dennis Moberg points out, "After Ebbers and Sullivan left the company, "...Cooper was treated less positively than her virtuous acts warranted. In an interview with her on 11 May 2005, she indicated that, for two years following their departure, her salary was frozen, her auditing position authority was circumscribed, and her budget was cut""(Moberg, 2006, 416).

As far as the protagonists are concerned, in April 2002, CEO Bernie Ebbers resigned and two months later, CFO Scott Sullivan was fired. Shortly thereafter, in August 2002, Sullivan and former Controller David Myers were arrested and charged with securities fraud. In November

2002, former Compaq chief Michael Capellas was named CEO of WorldCom and in April 2003, Robert Blakely was named the company's CFO.

In March 2004, Sullivan pleaded guilty to criminal charges (McCafferty, 2004). At that time, too, Ebbers was formally charged with one count of conspiracy to commit securities fraud, one count of securities fraud, and seven counts of fraud related to false filings with the Security and Exchange Commission (United States District Court - Southern District of New York, 2004). Two months later, in May of 2004, Citigroup settled class action litigation for \$1.64 billion after-tax brought on behalf of purchasers of WorldCom securities (Citigroup Inc., 2004). In like manner, JPMorgan Chase & Co., agreed to pay \$2 billion to settle claims by investors that it should have known WorldCom's books were fraudulent when it helped sell \$5 billion in company bonds (Rovella, 2005).

On March 15, 2005, Ebbers was found guilty of all charges and on July 13th of that year, sentenced to twenty-five years in prison, which was possibly a life sentence for the 63-year-old. He was expected to report to a federal prison on October 12th, but remained free while his lawyers appealed his conviction (Pappalardo, 2005).

At the time of his conviction, Ebbers' lawyers claimed the judge in the case gave the jury inappropriate instructions about Ebbers' knowledge of WorldCom's accounting fraud (Pappalardo, 2005). By January of 2006, Reid Weingarten, Ebbers' lawyer, was claiming that the previous trial was manipulated against Ebbers because three high level WorldCom executives were barred from testifying on Ebbers' behalf. At that time, too, Judge Jose Cabranes of the US Second Circuit Court of Appeals commented, "There are many violent criminals who don't get 25 years in prison. Twenty years does seem an awfully long time" (MacIntyre, 2006). Weingarten went on to assert that the government "should have charged the three former WorldCom employees that could have helped exonerate Ebbers or let them go" (Reporter, 2006). He charged, too, that "the jury was wrongly instructed that it could convict Ebbers on the basis of so-called "conscious avoidance" of knowledge of the fraud at WorldCom" (Reporter, 2006). Perhaps most compellingly, Weingarten called into question the fairness of Ebbers' sentence that was five times as long as that given to ex-WorldCom financial chief Scott Sullivan (Reporter, 2006).

Weingarten's claims are not without merit. In August 2005, former CFO Sullivan was sentenced to five years in prison for his role in engineering the \$11 billion accounting fraud. His relatively light sentence was part of a bargain wherein he agreed to plead guilty to the charges filed against him and to cooperate with prosecutors as they built a case against Ebbers. In doing so, Sullivan became the prosecution's main witness against Ebbers and the only person to testify that he discussed the WorldCom fraud directly with Ebbers (Ferranti, 2005). Others involved in the scandal were also treated less harshly than Ebbers. In September 2005, judgments were rendered approving settlement and dismissing action against David Myers and a number of others associated with WorldCom (United States District Court - Southern District of New York, Judgment Approving Settlement and Dismissing Action Against Buford Yates and David Myers, 2005, Judgment Approving Settlement and Dismissing Action Against James C. Allen, Judith Areen, Carl J. Aycock, Max E. Bobbitt, Clifford L. Alexander, Jr., Francesco Galesi, Stiles A.

Kellett, Jr., Gordon S. Macklin, John A. Porter, Bert C. Roberts, Jr., The Estate of John W. Sidgmore, and Lawrence C. Tucker, 2005).

At the time of this update, Ebbers has been convicted by a court of law, but remains free on bail while he pursues an appeal. Although the extent of his punishment is under contention, one thing remains clear - that Ebbers and the other officers at WorldCom are guilty of presiding over what is to date, the largest corporate fraud in history.

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