

# New reports on criminality at WorldCom

Joseph Kay  
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One year since the accounting fraud perpetrated by telecommunications giant WorldCom first emerged, two reports related to investigations into the company's practices have been released, shedding further light on the machinations of former CEO Bernard Ebbers and other top executives.

At the order of the bankruptcy court overseeing WorldCom's case, former US attorney general Dick Thornburgh prepared one of the reports. The other, overseen by William McLucas of the law firm Wilmer, Culter & Pickering, was prepared at the request of WorldCom's current board of directors.

The McLucas report provides evidence that Ebbers was aware of what became known as "stop the gap" meetings, which were allegedly organized by former chief financial officer Scott Sullivan. The "gap" refers to the separation between WorldCom's earnings and what the company had to report in order to meet Wall Street expectations.

In particular, the report cites a voice mail message left by Sullivan for Ebbers in June, 2001 describing the monthly revenue reports as "getting worse and worse...[the] copy that you and I have already has accounting fluff in it...all one-time stuff or junk."

Ebbers studiously avoided leaving a paper trail that could implicate him in the financial shenanigans. However, a July 10, 2001 memo cited by the McLucas report from Ebbers to the company's former chief operations officer states, "I would ask that you get Jon McGuire and Mike Higgins [two other executives] and anyone else who works on those issues and see where we stand on those one-time events that had to happen in order for us to have a chance to make our number..."

The "one-time events" referred to were additions to company revenue reports that temporarily boosted reported short-term earnings. Largely by using such measures, WorldCom increased reported earnings from 6 percent to 12 percent during the third quarter of 2001. Another method frequently used to stop the gap was to report routine earnings as capital expenditures, which could be deducted from revenue over a long period of time rather than all at once.

Higgins, the vice president of finance at the time, sent an e-mail warning others not to forward the monthly revenue reports that provided evidence of the manipulations. "Please do not forward," he wrote, "because Bernie is extremely concerned with forwarded or passed on mon rev results."

The McLucas report also faults a number of other top executives, many of whom have left the company to take up jobs elsewhere. To cite only one example of many, according to an unidentified employee, Buddy Yates, then director of general accounting, told an employee who had raised questions about accounting practices, "Show those numbers to the damn auditors and I'll throw you out the (expletive) window."

Arthur Andersen, WorldCom's auditor during the period, failed to question or report the financial fraud taking place. Even though it was systematically denied access to certain important financial records, the auditor continued to approve the company's books. This is in spite of the fact that Andersen had labeled the company as a "maximum risk client" for fraud or accounting errors throughout the period from 1999 to 2001.

The Thornburgh report also raises questions of possible insider trading on the part of Ebbers. In late September 2000, Ebbers sold \$70 million in WorldCom stock, a transaction that occurred immediately after Ebbers

learned of a downturn in company revenues. Information on the downturn was not made public for another month.

On June 25, 2002 the company disclosed that it had incorrectly accounted for \$3.8 billion, a figure that over the next several months would climb to \$11 billion. It was by far the largest instance of accounting fraud in corporate history. One month earlier, CEO Ebbers had resigned, and in July another record was broken when WorldCom declared the largest bankruptcy ever.

The collapse of WorldCom marked a high-point in a wave of financial scandals that engulfed the United States, beginning with the Enron revelations of late 2001. Tyco, Rite Aid, Xerox, Kmart, Global Crossing—one revelation followed upon another. Perhaps more than any of the others, however, the rise and fall of WorldCom epitomizes the orgy of financial and stock market speculation, debt financing and accounting fraud that has become commonplace in corporate America.

The crisis at WorldCom was not unique or accidental. Rather it reflected in the most stark form deep internal contradictions within American capitalism, contradictions that have not gone away in spite of attempts to cover them with token reforms. Indeed, recent weeks have seen the surfacing of a new crop of accounting scandals—at IBM, Coca-Cola and, most recently, the home mortgage giant Freddie Mac.

WorldCom has its origins in Long Distance Discount Services (LDDS), which was formed in 1983. LDDS, a small company privately owned by Ebbers and a few other investors, initially struggled, but found an avenue of expansion after the break-up of the AT&T monopoly in 1984, which opened the way for smaller companies to enter the long-distance telephone market. Ebbers took over control of the company in 1985 and began an acquisition binge that would last over a decade and a half.

This process was gradual at first. Since the company was privately owned, capital to carry out acquisitions was difficult to come by. This changed when the company went public in 1989, with a stock value of about 90 cents. LDDS—renamed WorldCom in 1995—was well-positioned to take advantage of the speculative market of the 1990s.

Merger after merger pushed up annual revenues, from \$8.6 million in 1986 to \$700 million in 1991, \$3.9 billion in 1995, \$17.6 billion in 1998 and \$35.2 billion in 2001.

"People began to get on the train," said David Singleton, an early investor in Long Distance Discount Services (LDDS), "and the train got bigger. And the bigger it got, the faster it ran. The faster it ran, the easier it was to get somebody on it and the higher the stock went. There was always a deal cooking. We were buying something every time we had a board meeting, it seemed." (Quoted from *Disconnected: Deceit and Betrayal at WorldCom* by Lynne Jeter, p. 46).

Of course, the expansion did not come without cost. WorldCom accumulated some \$30 billion in debt over the period. So long as the stock bubble continued to swell, the debt could be financed with company stock and the real state of the company could be obscured.

A number of financial manipulations were carried out to this end. In particular, WorldCom recorded about \$50 billion in goodwill, an accounting concept that is meant to represent the value of an asset that extends beyond its material price (for example, the value of a trademark).

However, WorldCom used goodwill essentially to cover the difference between the real value of its acquisitions and the price it had paid, thereby keeping reported earnings up.

In its speculative fever, Wall Street tuned a blind eye to WorldCom's underlying financial difficulties, as it did for a whole host of dot.com and telecom companies. In 1996, WorldCom was number one on the *Wall Street Journal* list of companies with high shareholder return.

Ebbers became the darling of the business press, as did chief financial officer Scott Sullivan, who in 1998 received the CFO Excellence Award for Mergers and Acquisitions. At the time Sullivan was earning close to \$20 million a year. For Wall Street, these accolades were well-deserved. Since 1990, thanks to a skyrocketing share value, investors had received a return of 225-to-1.

In 1998, the company completed its biggest deal yet: the unsolicited takeover of MCI for \$38 billion. The acquisition was extraordinary, because MCI was easily three times the size of WorldCom. But as AOL would later do with its acquisition of Time Warner, WorldCom could leverage its inflated stock value to finance the deal. By June of 1999, the company's stock value reached a high of nearly \$65.

On the basis of its takeover of MCI and some 70 other companies, WorldCom had become the nation's second largest long-distance provider and the world's largest Internet carrier. The value of the company had grown 7,000 percent over the course of the decade.

Ebbers had risen from small-time Mississippi hotel owner and basketball coach to become one of the world's richest men, amassing a net worth of \$1.4 billion.

WorldCom and Ebbers had forged close ties with Wall Street, particularly Salomon Smith Barney and its star analyst Jack Grubman. Ebbers and other executives were some of the principal beneficiaries of the practice of spinning, whereby investment banks doled out hot initial public offering (IPO) stock to top executives at major client firms in return for banking business. Between 1996 and 2000, Ebbers made \$11 million on 869,000 shares in 21 different companies. Salomon received \$107.1 million in fees from WorldCom for investment-banking operations between October 1997 and February 2002.

Ebbers was not the only one to benefit. Former WorldCom director Walter Scott made \$2.4 million on the sale of shares he received on just one IPO underwritten by Salomon, that of Qwest Communications in 1997.

The year 1999 marked the high water mark of the telecommunications stock bubble, and the company's share value began to slip. In 2000, WorldCom was forced to abandon the attempted takeover of another long-distance giant, Sprint, due to the opposition of American and European regulators. As WorldCom's stock value fell—down to \$46 after the failure of the Sprint deal—the entire edifice that had been constructed upon the vastly inflated price of WorldCom shares began to teeter.

The company responded to the growing crisis in two ways: first, by cutting costs and laying off employees, including 6,000 in February of 2001; second, by systematically cooking the company's books in order to meet Wall Street expectations.

As the WWS has explained (See "Drawing the Lessons of WorldCom," July 2, 2002), the phenomenon of WorldCom was not an aberration, nor was it simply the product of bad people. Rather, the frenzy of stock market speculation that nurtured WorldCom was a consequence of deep contradictions in the capitalist economy itself. Faced with declining profit rates—a decline that began in the 1970s but became acute during the first half of the 1990s—American business turned increasingly to speculation and fraud as its means of accumulation.

WorldCom's acquisition binge was one manifestation of this parasitism. It involved wealth transfer rather than wealth creation through the normal process of capitalist exploitation. The debts racked up by WorldCom would eventually come due; the extravagant share values would

eventually fall. This was inevitable, and someone would have to pay.

A handful of WorldCom executives have been charged, and Ebbers himself may very well be next. However, the government's attempts to present itself as opposing corporate corruption by throwing a few of the crooks in jail—excluding those, such as former Enron chief Kenneth Lay, with close ties to President Bush—is meant more to obscure than to reveal the real causes and real consequences of the corruption. This is why the McLucas and Thornburgh reports, while providing some useful information, do not attempt to answer the overriding question: How was such fraud possible?

The entire American ruling elite participated in the speculative orgy from which WorldCom emerged. Everyone received a share. Wall Street and the big investors benefited from the stock market speculation and the big banks received lucrative commissions on every new stock issue. The auditors—including WorldCom's auditor, Arthur Andersen—ignored obvious accounting irregularities in exchange for consulting contracts. The political establishment encouraged and benefited from the process. WorldCom was closest to the Democratic Party, though it was tied to both parties, and Enron was until its collapse the principal corporate backer of Bush.

The burden of paying for this fraud will fall primarily on the backs of working people.

Last week, the SEC and WorldCom announced that they had reached a settlement on fraud allegations that would fine the company \$500 million. If accepted by the judge overseeing the case, this money will be distributed amongst former shareholders. While an unprecedented amount for such a settlement, it is a paltry sum compared to the nearly \$200 billion in share value that was wiped out when the company's stock price collapsed in the wake of the fraud revelations.

If approved, the \$500 million will be distributed in some as yet undetermined way amongst WorldCom shareholders. "There were so many shareholders that were harmed by WorldCom that it is hard to hold out hope that they will get any significant benefit," said Drake Johnstone, a telecommunications analyst with Davenport & Co. The bulk will go to large investors, while the thousands of workers laid off by the company, and the many small investors who were hit by the stock market collapse, will get very little.

This is mirrored in the economy as a whole. The economic crisis that has emerged in the wake of the stock market collapse is being used to justify massive attacks on social programs, education, jobs and wages. This has been combined with sharp cuts in taxes on corporations and the wealthy—tax cuts enacted by an administration that is largely composed of individuals directly implicated in corporate scandals of their own. The war in Iraq is another component of an enormous transfer of wealth, as the American ruling class shifts the burden of its own crimes onto the shoulders of ordinary people around the world.



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