Ebbers found guilty in WorldCom fraud: a case study of US corporate criminality

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Former WorldCom CEO Bernard Ebbers was convicted Tuesday on nine counts of conspiracy, securities fraud and filing false documents with the Securities and Exchange Commission. The jury in the Manhattan trial held Ebbers responsible for fraudulent practices that culminated in the biggest bankruptcy in US corporate history.

WorldCom filed for bankruptcy in July 2002, its debts dwarfing its $104 billion in assets. The collapse was nearly twice the size of the previous largest bankruptcy, the 2001 failure of Enron.

The company announced that an internal investigation had uncovered $11 billion in fraudulent accounting entries. This figure later swelled: a second report in 2003 found that during the last two years of Ebbers' tenure as CEO, the company had over-reported earnings and understated expenses by an astonishing $74.5 billion.

The resulting collapse wiped out the value of the company's stock, destroying the pension holdings of tens of thousands of WorldCom workers. More than half of the company's workers lost their jobs as well as their pension savings. The work force in what remains of WorldCom, now renamed MCI, is down from 101,000 to only 40,000.

Ebbers was one of the most celebrated CEOs of the last decade, lauded in the American media for taking a small Mississippi-based long distance company and transforming it into one of the largest telecommunications empires, through a campaign of mergers and acquisitions that culminated in the $47 billion merger of WorldCom and MCI in 1998. All told, Ebbers took over 65 separate companies, nearly all in transactions financed by the booming stock market of the mid- and late 1990s.

In 2000, as the Internet and telecom boom cooled, WorldCom's growth slowed. When the company's stock price sagged Ebbers found himself in personal financial difficulty, as he had bought enormous quantities of WorldCom stock "on margin"—using the value of the stock as collateral.

In October 2000, Ebbers induced the WorldCom board of directors to approve a personal loan to him of over $400 million, so that he could pay his margin calls. This staved off the immediate crisis, but he faced potentially ruinous demands for more collateral if the stock price fell below $12 a share. At $10 a share, all his loans would have been immediately called in, and a financial debacle loomed.

This was the impetus, according to the prosecution case, for an extensive scheme of double-bookkeeping that allowed the company to report steadily higher earnings and maintain the stock price above the critical level. WorldCom Chief Financial Officer Scott Sullivan oversaw the operation. He pleaded guilty last year to three counts of conspiracy and fraud, and served as the star prosecution witness against Ebbers.

By Sullivan's account, backed up by the testimony of numerous lower-ranking former WorldCom executives, the company began to classify outlays on everyday costs as capital expenditures—a fiction that allowed the firm to report higher operating margins and profits. Much of WorldCom's biggest single operating expense, charges for renting lines from other telecommunications providers, was reclassified in this way, and the level of false bookkeeping rapidly mounted to as much as $1 billion a month.

WorldCom created spreadsheets that recorded the two versions of the company's books side-by-side: a "normalized" version that reflected actual operating expenses, and a "final" version, adjusted to meet market expectations. Former accounting manager Lisa Taranto testified that she and her staff personally delivered copies of the company's monthly revenue reports to Ebbers' office, with details of the one-time changes that would raise the company's net income to the desired level.

The cumulative amount reached staggering dimensions. For 2000, WorldCom initially claimed a pre-tax income of $7.6 billion. After the bankruptcy filing and a complete reworking of the books, the figure was restated to a loss of $49.9 billion. For 2001, the claimed pre-tax income of $2.4 billion was restated to be a loss of $14.5 billion. In 2002, the company ultimately reported a loss of $9.1 billion.

Sullivan testified that WorldCom called off merger talks with Verizon Communications in the summer of 2001 because he and Ebbers feared that the required exchange of confidential information would expose the inflation of their company's earnings.

The vast scale of the accounting discrepancies ultimately broke through the efforts at concealment, as more and more accounting employees had to be enlisted in the scheme. Three mid-level officials balked at signing off on false numbers in April 2002, touching off the internal investigation that brought down the house of cards. Ebbers was forced to resign and the company filed for bankruptcy shortly thereafter.

The only real hurdle for the prosecution case was that Ebbers, despite two decades as CEO of a high-tech company, refused to use e-mail. His instructions to his subordinates concerning the company's financial operations were given orally, nearly always in private discussions with Sullivan, who then supervised their implementation. This practice allowed Ebbers' lawyers to argue that Sullivan alone had originated the fraud and that Ebbers was unaware of it.

There was, however, considerable direct evidence of Ebbers' role in the fraud, including testimony from several WorldCom executives other than Sullivan who had conversations with Ebbers about cooking the books. Even more significant was the mass of circumstantial evidence about Ebbers' management style.

Former WorldCom employees testified that Ebbers would routinely query them on even minute costs. At one point he cancelled the company coffee service after an investigation revealed that employees were consuming too many bags of coffee, as compared to the number of filters used. Ebbers concluded that this proved workers were taking coffee home to their families, and he ordered an end to the service—at a savings of $4 million annually.

He also demanded that an Atlanta-based executive drive to Mississippi for meetings rather than fly, to save money, and even ordered a security guard at WorldCom's office near the Pentagon to refill water coolers with tap water rather than bottled water, saying the employees would not know the difference.

It was less than plausible to argue that an executive so focused on cutting costs would not have noticed that the company's largest single cost, for line rentals, was gyrating by hundreds of millions of dollars from month to month. At one point during the cross-examination of Ebbers, prosecutor David Anders presented him with a series of documents showing the huge changes in line costs. "I did not notice that," Ebbers said. "I just didn't see it."

"WorldCom reduced its line costs by over $2 billion and you had no idea?" Anders asked. "That's correct," Ebbers replied.

Ebbers' lawyers sought to present him as an unschooled and perhaps dimwitted executive who was a victim of clever machinations by his underlings. In his testimony in his own defense, Ebbers said that his "marks weren't too good" in college, recounted his pre-CEO career as a milkman and basketball coach, and claimed that he understood neither the technology nor the finances of the telecommunications industry.

"The closest thing I've ever had to an accounting course is a preliminary course on economics," he said. "I know what I don't know. To this day I don't know technology, and I don't know finance and accounting." He said his role at the company was primarily as a marketer and "coach" to the company's sales force.

Even the American media found it difficult to swallow this argument. The *New York Times* noted the contradiction between the enormous salaries of CEOs like Ebbers, Enron's Kenneth Lay and Richard Scrushy of HealthSouth, and their current claims of being out of the loop when their companies were being looted: "Now, some of those same chief executives find themselves in the uncomfortable position of arguing that while they were richly compensated, when it came to corporate financial activity, they were little more than caretakers who paid little attention to details."

In a scathing editorial against what it described as "The Idiot Defense," the *Los Angeles Times* wrote: "Assume for a moment that Ebbers, Lay and Scrushy are innocent, and that other men and women in pinstripes left them holding the bag. The question then becomes: What was this confederacy of dunces doing to earn its massive paydays?"

If the editorial representatives of giant media conglomerates could not accept such claims, a working class jury was even less likely to do so. Ebbers' fate may well have been assured as soon as the jury was selected for his six-week trial.

The panel was a cross-section of working class New Yorkers, with three transit workers, two schoolteachers, a worker at Time Warner Cable and three bank employees among its 16 members (12 jurors and four alternates). They clearly did not buy Ebbers' defense that he was unaware of the financial manipulations that produced the biggest bankruptcy in US corporate history.

Juror Vincent Wright, a Manhattan bus driver who spoke to the media after the verdict, said the jury had agreed in the first two days of deliberations that Ebbers was guilty of securities fraud and filing false documents, eight of the nine charges. The initial vote on the ninth charge, conspiracy, was 8-4 for conviction.

While the media coverage of the trial focused on the conflicting accounts of Sullivan and Ebbers, hinting Ebbers might be acquitted, several jurors said they did not believe either top executive and based their decision on the documentary evidence and the testimony of other witnesses. Aran Nulty, a grade-school teacher, said that the jury could not believe that Ebbers, with his entire personal fortune riding on WorldCom's stock price, could have been ignorant of the details of the company's financial performance.

In response to the verdict, US Attorney General Alberto Gonzales issued a statement saying, "Today's verdict is a triumph of our legal system and the application of our nation's laws against those who breach them. We are satisfied the jury saw what we did in this case: that fraud at WorldCom extended from the middle-management levels of this company, all the way to its top executive."

Despite the sanctimonious tone of this pronouncement, there is little doubt that the jury verdict has sent chills, not only through corporate boardrooms, but through the upper echelons of the US government. If they faced the same standards as Ebbers, top officials of the Bush administration, including Bush himself, would stand convicted of far greater crimes—not only in falsifying the finances of the federal government on a scale which puts WorldCom in the shade, but in the systematic campaign of lying that has accompanied its foreign policy of military aggression.

The case of Bernie Ebbers has shed further light on the increasingly criminal character of the practices of corporate America, which finds its concentrated political expression in the Bush administration.