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WorldCom Stockholders Owe SEC Thanks for Almost Nothing

By Jerry Knight

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Look at this: \$500 million, the toughest penalty ever imposed for corporate wrongdoing, the Securities and Exchange Commission boasted last week when it settled its investigation of accounting fraud at WorldCom Inc., soon to be renamed MCI.

That's not only \$490 million more than the second-largest fine ever, the SEC bragged. This time it is going back to the poor investors who lost money because the books were cooked.

That's one way of looking at it.

Another is that the payback would be only about 17 cents a share for WorldCom stockholders -- if they were to get all of it. That's not much compensation for somebody who paid \$60 a share for the stock four years ago when its value was inflated by phony accounting.

In fact, defrauded shareholders will have to split the pot with people who bought MCI and WorldCom bonds. The \$500 million comes to something like one-350th of the roughly \$175 billion lost by investors on the stock and bonds.

The \$500 million is not only a pittance, it's also a pointless penalty that takes money out of the pockets of some MCI victims and puts it in the pockets of others.

Along with doing next to nothing to compensate investors, it does nothing at all to deter other corporate crooks from the same kind of phony bookkeeping.

The harder you look at the penalty imposed on MCI, as the company now wants to be called, the clearer it becomes that nobody in Washington has figured out the appropriate punishment for colossal corporate fraud.

The SEC obviously thinks that slapping the company with a record fine is the right thing to do.

Business ethics experts are dubious.

They argue that WorldCom-MCI is a victim of fraud by its own executives. The crooks are the ones who

should be punished, not the company.)

At the other end of the range of options are people calling for the corporate equivalent of capital punishment. The right thing to do, they contend, is to put MCI out of business and distribute its assets to the investors who were victims of the fraud.

"This is just a tragic situation, where there is no appropriate punishment other than prosecuting the perpetrators," said Edward Soule, assistant professor of managerial ethics at Georgetown University. "But the perpetrators are all out of WorldCom and they are being prosecuted."

There is no point in fining MCI, Soule said. "It's like beating a corpse. It's hard to see what this is going to accomplish."

Fining MCI is punishing the victim, agreed Charles M. Elson, professor of corporate governance at the University of Delaware.

"The damage was done to the company, which is the shareholders and the bondholders and the employees," Elson said. The fine "is coming out of the company. It's coming out of one pocket and going into another."

One problem with fining MCI is that the company is in Chapter 11 bankruptcy protection. It doesn't have enough money to pay its creditors, let alone make stockholders whole.

The SEC is stepping into the bankruptcy case, in effect rearranging the line of creditors waiting to be paid.

Usually banks are first in line in bankruptcy. They are typically "secured" creditors, because in return for lending the company money, they got a lien on its assets. It's just like the bank getting a lien on your car when you get a loan.

Bondholders are next in line. While bond debt is generally unsecured, bondholders usually have a more senior position in bankruptcy than your standard unsecured creditors -- mostly the suppliers who sold stuff to the company. Unsecured creditors don't have liens and generally they get paid less of what they are owed than the secured creditors. Sometimes they get nothing at all.

At the end of the line are the stockholders. They are the owners of the company, and legally they are not entitled to get anything until the creditors have been paid in full.

What the SEC has done is grab \$500 million of MCI's money and given it to the bondholders -- who were entitled to it anyway -- and to the stockholders, who otherwise wouldn't get a dime. The SEC may be helping the shareholders, but in doing so it steps on the legal rights of the creditors, taking money out of their pockets to pay the stockholders.

The argument for rearranging the bankruptcy line might be more appealing if the money involved weren't so trivial. At 17 cents a share, someone who bought a thousand shares of MCI stock at \$60 a share and lost \$60,000 will get \$170 back. Big deal.

The two ethics professors agreed on most points, but not on the issue of corporate capital punishment.

The capital punishment argument is that if you're going to fine MCI and give the money to investors, give them everything you can get. Auction off everything and divvy up the dough among the victims.

Putting MCI out of business wouldn't be fair to the thousands of MCI employees who had nothing to do with inflating sales and profits, Elson argued.

But keeping MCI alive isn't fair to the companies it competes with in the telecommunications industry, many of which kept their books straight and had to slog through the slump without the benefit of debt-reducing bankruptcy. It can be argued that if MCI hadn't lied about its finances, it would have run out of money and died a natural death several years ago.

"Are the bankruptcy laws really serving the public interest?" Soule said. "If you have a business that we have been led to believe suffers from overcapacity of biblical proportion, then what bankruptcy is doing is allowing that condition to perpetuate."

Lots of free-market economists and telecom experts would agree that the business and the country would be better off if MCI were wiped off the face of the earth. Getting rid of it would cut the glut of phone lines, reduce the cutthroat competition and make everybody else in the business healthier and more profitable. It would speed up a process of adjustment that otherwise would drag on for years, leading to a more efficient industry.

Not surprisingly, the leading advocates of the death penalty for MCI are its competitors.

Mild-mannered ethics professors sound like cops seeking vengeance when it comes to what ought to be done to the executives who were involved in years of fraud that kept MCI looking profitable when it was really losing money by the billions of dollars.

Those people were fired long ago and now are targets of criminal charges and continuing investigations. Almost anyone you talk to about the MCI matter wants the scalps of WorldCom founder Bernard J. Ebbers and his top lieutenants, who made millions of dollars as the company's books were cooked.

Putting the people responsible behind bars and taking away the money they made would be the best way to deter other would-be corporate crooks, the MCI victims, the ethics professors and the securities lawyers agree.

If they are guilty as charged (Ebbers has not been accused of a crime), they belong in jail or the poorhouse, or, preferably, jail then the poorhouse.

"The poorhouse is not the best," Soule said. "You want to see them do time."

Unfortunately, white-collar criminals rarely go to jail or end up impoverished, Soule said. "If you look at history, it's very hard to get convictions. That's why so many of these cases are settled."

"There are proof problems. It's very difficult to lock people up," Elson agreed. The problem is explaining complex financial crimes to a jury. It can take weeks to outline an accounting-fraud case and prosecutors are reluctant to take the chance that jurors won't get it, so they cut deals. By definition, a deal means prosecutors don't get everything they want -- not as much jail time, not as big a fine.

Some of Washington's best defense lawyers are already working for the executives implicated in the MCI cases, among them Ebbers and WorldCom's former chief financial officer, Scott D. Sullivan.

Sullivan has built a \$15 million family compound on five acres of prime Florida beachfront. Even if he is convicted, jailed, fined and forced into bankruptcy, Sullivan will get to keep his house because it is protected by Florida's "homestead" law.

Designed to keep poor farmers from being thrown out of house and home, the Florida law basically says a court cannot take away someone's principal residence.

That would change under a new law proposed last week by Republicans Michael G. Oxley of Ohio, chairman of the House Financial Services Committee, and Richard H. Baker of Louisiana, chairman of that panel's financial services subcommittee.

Their bill would give government prosecutors and regulators new powers to go after the assets of corporate criminals and would override "homestead" laws such as Florida's. As examples of why the law is needed, the lawmakers cited Sullivan's estate and a 500,000-acre ranch in Canada that Ebbers owns.

Oxley was co-author, with Sen. Paul S. Sarbanes (D-Md.), of the law that empowered the SEC to levy the \$500 million fine on MCI and give the money to investors. Before, the money would have gone to the U.S. Treasury.

There's reason to question whether the Sarbanes-Oxley fine was the best way to handle the MCI situation, but everyone from MCI employees to corporate ethics experts endorses Oxley's latest idea.

If the bill introduced last week becomes law, Oxley and Baker may get their names on it, but it could have a much better name. Call it the Ebbers-Sullivan law. Then everyone would understand its target. MCI investors would get as much satisfaction from that as they would get from the puny checks they collect as their shares of the \$500 million fine.