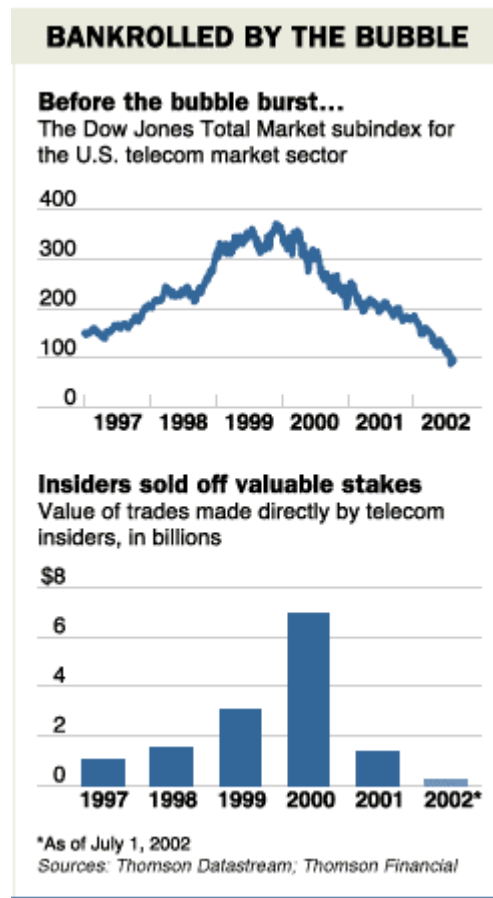


Before Telecom Bubble Burst, Some Insiders Sold Out Stakes

By Dennis K. Berman
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(PFD File)

These days, Vincent Galluccio spends most afternoons at the wheel of a tractor, overseeing his \$5.2 million Long Island vineyard, Galluccio Family Winery. Just two years ago, Mr. Galluccio was one of thousands of executives overseeing a different product: telecommunications.

Mr. Galluccio, 57 years old, was a top European executive of Metromedia Fiber Networks Inc., a high-flying White Plains, N.Y., telecom-network builder. As Metromedia's value soared to its peak of \$31 billion, Mr. Galluccio began selling small amounts of shares. Leaving the company in 2000, he liquidated all of his holdings, for a total of about \$27 million. He used the proceeds to buy the 160-acre winery known for its Chardonnays.



Metromedia has since landed in less idyllic territory: In May, it filed for Chapter 11 bankruptcy protection and the Securities and Exchange Commission is examining the accounting practices the company used after Mr. Galluccio's departure. Mr. Galluccio is unapologetic about his haul, having worked 18-hour days for three straight years. "My father taught me that when you play poker and win a hand, put half in your pocket and walk away from the table," he says.

The telecommunications industry, once a safe stock haven for "widows and orphans," became a gigantic poker game during the late 1990s, a competitive, high-growth business drawing billions of dollars of fresh capital. Supported by bullish Wall Street analysts and investment banks eager to reap big stock-offering fees, industry executives helped the pot grow bigger and bigger with

talk of telecom's endless growth possibilities. Then, by the hundreds, they folded their hands at what turns out to have been the peak.

Starting in 1997, telecom insiders directly cashed out over \$14.2 billion in shares, a Wall Street Journal/Thomson Financial analysis shows. Add in shares sold by venture capitalists, executives' trusts and private investment vehicles, and the number soars to roughly \$18 billion.

Some of the sales by telecom insiders have been truly massive. Qwest Communications International Inc. founder Philip Anschutz sold nearly \$2 billion of shares, and former chief executive Joseph Nacchio sold about \$250 million. Global Crossing Ltd. founder Gary Winnick sold \$734 million in shares on a \$20 million investment. Global Crossing entered Chapter 11 proceedings in January and reached an agreement to be sold on Friday.

A spokeswoman for Mr. Winnick said that all of his trades followed applicable rules and were reviewed by company attorneys at the time. A representative for Mr. Nacchio said all of his sales were in compliance with trading regulations. A spokesman for Mr. Anschutz said that the executive had put \$1 billion of his own money into Qwest and declined to comment further.

WorldCom Inc. Chief Executive John Sidgmore, who predicted nearly endless growth for the industry as head of UUNet, the Internet backbone purchased by WorldCom in 1996, sold a total of \$87 million in WorldCom stock. WorldCom filed for Chapter 11 bankruptcy protection earlier this summer and was slapped with civil charges by the SEC after reporting the biggest corporate accounting fraud in history.

"The point of my presentations always was the Internet infrastructure and the capacity of our network was growing 10 times between 1994 and 1997," Mr. Sidgmore says, adding that the overwhelming portion of his sales were of holdings that were originally UUNet shares, not newly issued WorldCom shares. "The only thing I've sold since 1999 were transfers into trust funds for nieces and nephews," he says.

But the insider selling went far beyond the Winnicks and Sidgmores of the industry. The selling also reaped huge profits for hundreds of relatively unknown telecom executives such as Mr. Galluccio. Their fortunes are indicators of just how much the telecom bubble expanded, enriching executives at companies with the most limited track records. Today, of the 305 companies canvassed in the Journal survey, 38 have total insider sales since 1997 greater than their current market capitalizations.

All told, it is one the largest transfers of wealth from investors -- big and small -- in American history. Hundreds of telecom executives, almost uniformly bullish, sold at least some portion of their stock and made hundreds of millions of dollars, while many investors took huge, unprecedented losses. It dwarfs the much more highly publicized Internet boom and bust. And the economic and personal damage in jobs lost and bankruptcies is far worse.

With over 60 bankruptcies to date, it's now clear that the sector sank under too much capacity and debt. Telecoms have now shed half a million jobs and about \$2 trillion in market capitalization.

At JDS Uniphase Corp., a maker of fiber-optic components, insiders unloaded nearly \$1.2 billion of shares over the past five years. The company is now valued at \$3.5 billion. Insiders at Foundry Networks Inc., a San Jose, Calif., maker of switches for data networks, have sold close to \$700 million in shares since 1997. The company is now valued at about \$1 billion. Even at now-defunct wireless-data provider Metricom Inc., San Jose, Calif., where yearly revenues never exceeded \$18.5 million, insiders managed to sell off more than \$35 million.

To be sure, in most cases, the selling was perfectly legal -- and was duly reported in filings with the SEC. Insiders have every right to sell their shares and turn a profit. If part of their compensation comes through stocks and options, they have full sway to diversify their portfolios. And unlike many established companies, the new telecom players faced a higher-risk proposition: The stock didn't pay dividends because there often weren't any profits. Executives point out that regular shareholders are free to sell whenever they wish. Most say they only sold a small percentage of their overall holdings into the market, and nearly all were prevented from selling stock within the "lock-up period," or 180 days after their companies' public offerings.

But with much of the industry in utter collapse, investors are puzzled and angry that they didn't understand how short-lived the boom would be. If telecom was supposed to be the backbone of a decades-long Digital Age, why were so many executives selling at the same time that they were predicting further growth? If timing is everything, was there something the insiders knew about the state of the industry that the general population of shareholders didn't?

Scores of shareholder lawsuits have flooded the courts, charging telecom executives with making misleading statements and selling their shares while prices were still high. No telecom executive has yet been charged with or convicted of insider trading, and such prosecutions only rarely stick. To be convicted of insider trading, prosecutors must prove that insiders used material, nonpublic information to sell for their personal gain.

That doesn't mean investors aren't feeling burned. "It's very frustrating as an investor," says Trent E. May, a former manager at Invesco Funds, whose portfolios suffered because of heavy investments in telecom and technology stocks. Executives "came public with these great stories about how they were doing so well, and then they come back to the market and sell 50% of their personal shares."

Surge of Reform

The crash and personal profiteering of the telecom industry have become a platform for the surge of corporate reforms sweeping through Congress and private-sector stock regulators. The response? Expensing options, restricting grants, limiting selling periods, pushing up the deadlines for insiders to disclose their sales and hauling executives off to jail in handcuffs before TV cameras. These all may play a role in calming investor anger.

But for now, few executives are publicly repentant about timing their sales so well while outside shareholders took a bath. Randall Kruep, former senior vice president at Redback Networks, a six-year-old company that went public in May 1999, says he "would have gotten out faster if I could have," and now wishes he could have sold double the \$100 million he sold in share transactions during 1999 and 2000. Tight trading "windows," which limit when insiders can sell their shares, prevented Mr. Kruep from doing additional selling, he says. The company's shares crested at a split-adjusted \$191.03 in March 2000. The shares now sell at \$1.07.

Now the chief executive of Procket Networks Inc., Mr. Kruep says he knew early on that the industry could not continue at its torrid pace. Executives who believed that the growth would continue, "didn't want to believe the truth. They didn't want to look a gift horse in the mouth."

Brian Smith, chief executive of Austin, Texas, equipment-maker Crossroads Systems, calls the amount of telecom insider sales "pretty small" given the overall size of the economy. In 1999, Crossroads went public, and in October of that year Mr. Smith began a regular share-selling program that has since brought in more than \$50 million, according to Thomson Financial. That's nearly three times the company's current market capitalization. Mr. Smith says financial advisers suggested he start selling shares as a way to diversify his holdings. As for Crossroads'

valuation, "it was consistent with what others were getting valued at," Mr. Smith says. "It didn't seem out of ordinary for the time. It seems out of the ordinary now."

Mr. Smith recalls a whirlwind period following the IPO, when the stock was often advancing as much as \$25 a day. Around that time, he says, the company's sales looked like they were going to grow 25% a quarter. Those expectations didn't pan out. Nine months after what was once the fifth-most-successful IPO in history, demand for the company's products began to slow. At the time, Mr. Smith called it a "bump in the road."

At JDS Uniphase, Chief Financial Officer Tony Muller was struggling to keep up with at least 20% growth between 2000 and the second half of 2001. The company scrambled to meet demand by opening new plants and snapping up competitors. "That was the world as we saw it," says Mr. Muller. But when the bottom fell out of the market, "Our customers were wrong and we were wrong."

Mr. Muller, meanwhile, was consistently selling his own shares -- tens of millions of dollars worth over the past five years. Mr. Muller says he consciously sold no more than 10% of his holdings, for fear of giving investors the impression that he wasn't committed to the company. In fact, Mr. Muller adds, he could have cashed, "a very big number." How big? "I don't want it to appear in print."

Mr. Muller's longevity trumps that of his former colleague, Mary Zita Cobb, a longtime JDS executive who was instrumental in a 2001 \$18 billion merger with SDL Inc., another maker of fiber-optic components. The value of the merger has since been largely written off, but Ms. Cobb hasn't been around to see it. She left the company soon after the deal closed, and is now circumnavigating the world on a sailboat, according to other JDS executives. Between 1999 and 2001, she sold stock valued at more than \$100 million. Ms. Cobb couldn't be reached for comment.

Former Redback Networks Chief Executive Dennis Barsema was bullish on the growth prospects of his company during March 2000, telling a television interviewer that the company was at the "very beginning stages of a market that is going to grow very, very fast."

That prediction held for the next nine months, when Redback quarterly sales grew by four times to nearly \$115 million. But the bottom would later fall out of the market, as Redback sales fell back to \$40 million during the first two quarters of 2002.

Eventually leaving Redback for another start-up, Mr. Barsema sold \$125 million in company shares, according to Thomson Financial. Mr. Barsema said that his entire net worth was tied up in the company, and he needed to diversify. "I don't think anyone knew we were in a bubble until we were on the other side of it," he says.

The hype was especially loud at four-year-old Sycamore Networks of Chelmsford, Mass. By all accounts, the company built a well-respected group of products used to manage what are called the "next generation" of telecommunications networks.

As company executives described it, Sycamore's fate was tied directly to that of the Internet. Locked together, the future of both seemed limitless when the company took its shares public in the fall of 1999. Sycamore was valued at \$14.4 billion after its first day of trading. By January 2000, Fortune magazine said the company had the best chance of becoming a "big boy."

Even after the dot-com bubble popped a few months later, Sycamore executives were publicly bullish on their market opportunities. One top sales executive noted in a June 2000 press

release that "next generation networks will continue to grow bigger and faster than anything we've seen before."

Just three months earlier, a group of seven top executives sold \$257 million of stock, at around \$144 per share. Three have since left the company. One, sales executive Ryker Young, recently moved to Oklahoma. He says he is "sitting on the sidelines" following an illness. Mr. Young declined to comment further about his stock sales, which totaled over \$65 million, according to Thomson Financial.

Deshpande Gururaj, Sycamore's chairman and chief executive, has sold about \$136 million since the IPO, or 4.5% of his total. A representative for Mr. Gururaj said he wasn't available for comment. Though Sycamore shares are now trading at below \$3, he recently told a Boston technology conference that he believes in the long-term prospects for telecom.

Deep Belief

Bobby Johnson Jr., founder of the profitable Foundry Networks, says he retains a deep belief in the promise of telecom, even after what he describes as "the most challenging 18 months of my 25-year career." The 45-year-old Mr. Johnson was once worth more than \$5 billion at the market peak. He now says that the industry was "in denial" around the time the company issued an earnings warning in December 2000. Mr. Johnson, who has sold about 25% of his holdings for about \$305 million, says he thought there would be a small dropoff in demand, and then it would be "back to the races in another few months."

Remarks Mr. Johnson made on Nov. 13, 2000, are the subject of a shareholder lawsuit filed in the U.S. District Court for Northern California. In an interview at the time, Mr. Johnson said that he was "not unhappy" with the company's stock price. He went on to say that "when the market fully values markets as well as companies, our stock price could go even higher." The next day, Foundry's shares jumped from \$66.75 to \$74.06. But they retreated to \$13 after the company posted an earnings warning on Dec. 19. The lawsuit alleges that Mr. Johnson, who had a regular program of selling shares, possessed information about Foundry's deteriorating condition when selling shares in October 2000. Mr. Johnson notes that the suit has been dismissed twice, adding that it is "without merit." Foundry's shares now trade at \$8.99.

Today, Foundry sells just 20% of its products to the telecom carriers who were its most avid original customers, and is now marketing them directly to corporations. Mr. Johnson backs away from the notion that Foundry hyped the Internet, whose growth has proved remarkable but far more modest than once expected. "I don't think we either inadvertently or advertently hyped the Internet," Mr. Johnson says. "We believed that there was a lot more that can be done with the Internet and can be done over time."

Like many of his telecom peers, Mr. Johnson insists that the multimillion-dollar paydays haven't changed his life much. "I still work as many hours as I did before," he says, adding he's given away more money than he spends.

Indeed, telecom executives have been generous with their largesse: Mr. Barsema, for instance, recently funded a new business school at Northern Illinois University, coming up personally with \$5 million in cash after awarding the school a stock gift of \$15 million. Mr. Smith, of Crossroads Systems, has funded international Baptist missionary groups. Donald Green, another Silicon Valley executive who made tens of millions of dollars in telecom stock sales, gave \$10 million to help build a 1,400-seat music hall in California's Sonoma County, modeled after the famous Tanglewood site in Massachusetts.

But even well-meaning gifts can do little to insulate telecom executives from public resentment. Mr. Johnson, for instance, admits that it's "not always pleasant to tell people you're a CEO these days." Congressional hearings into the telecom mess have become televised embarrassments for the industry's top brass. Some corporate activists are lobbying for telecom executives who presided over corporate bankruptcies to return their compensation to shareholders and employees.

David Oros is chief executive of Aether Systems, which builds wireless-data products for corporations. Aether's market capitalization is now about \$116 million. During 2000, his private-investment vehicle sold \$195 million of shares, according to Thomson Financial, and he later bought a \$2.5 million stone home inside the Baltimore city limits. Neighbors later groused about Mr. Oros's home remodeling, which included a reflecting pond, as well as butterfly and sculpture gardens, according to a person who has seen the house's preliminary plans. Mr. Oros says he's grown frustrated by criticisms about his stock sales, which occurred during a secondary stock offering in 2000. "I've given more in charitable contributions than I've paid for the house," he says, noting that he lives more modestly than some other executives. Mr. Oros has kept the same salary for three years, and is "proud of what we're doing for the city of Baltimore."

Some investors are looking to alter the kind of compensation structures that richly rewarded the telecom executives of the late 1990s. Such changes might further restrict how much, and how often, executives can sell their shares.

Carl Ferenbach, a venture-capitalist at telecom-backer Berkshire Partners, puts some of the blame for the huge industry payouts on himself. "We never really seemed to ask the question about huge amounts of money going in, supporting people who ultimately walked away with a lot of money," Mr. Ferenbach says. "It clearly was out of control everywhere, and in some sense, all of us who didn't scream loudly are to blame."