



United States
District Court,
Southern District
of New York, 2003.
273 F.Supp.2d 431.

Securities and Exchange Commission v. WorldCom, Inc.

BACKGROUND AND FACTS *Corporate officers and others supposedly acting on behalf of WorldCom, Inc., committed perhaps the largest accounting fraud in history. The loss to WorldCom's shareholders alone is estimated to be as much as \$100 billion. At the time of this writing, the individuals who allegedly perpetrated the fraud have been charged with crimes or are being investigated by the U.S. Department of Justice. WorldCom's creditors are seeking repayment in a federal bankruptcy court. Shareholders and employees have filed suits in federal district courts to recover what they can. Meanwhile, in another suit, the Securities and Exchange Commission (the Commission), which enforces federal securities laws (see Chapter 28), sought something different:*

- not just to clean house but to put the company on a new and positive footing;*
- not just to enjoin future violations but to create models of corporate governance and internal compliance for this and other companies to follow;*
- not just to impose penalties but to help stabilize and reorganize the company and thereby help preserve more than 50,000 jobs * * * .*

With these goals in mind, the Commission and the company's new management submitted to the court for its approval an agreement for the payment of a penalty of \$750 million—seventy-five times greater than any previous such penalty.

IN THE LANGUAGE OF THE COURT



RAKOFF, District Judge.

This case raises fundamental questions about how market regulators, and the courts, should respond when criminals use the vehicle of a public company to commit a massive fraud. While the persons who perpetrated the fraud can be criminally prose-

cuted, the exposure of the fraud often creates * * * pressures that can drive the company into bankruptcy, leaving * * * creditors with little and shareholders with nothing. Innocent employees may find their jobs in jeopardy, and, if the company is very large, entire segments of the market may be disrupted. In a situation where immense financial suffering is therefore likely, is there nothing government regulators can do to restore equilibrium?

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The first step in this journey, taken at the very outset of the litigation, was the joint decision of the parties to have the Court appoint a Corporate Monitor to oversee the proposed transformation. * * *

Under the Corporate Monitor's watchful eye, the company has replaced its entire board of directors, hired a new and dynamic chief executive officer and begun recruiting other senior managers from without, fired or accepted the resignation of every employee accused * * * of having participated in the fraud, and terminated even those employees who, while not accused of personal misconduct, are alleged to have been insufficiently attentive in preventing the fraud. In this connection, the company has already spent more than \$50 million of its own money to fund unrestricted investigations * * *, and their detailed reports have been given wide publicity.

The company has also consented to a permanent injunction authorizing the Corporate Monitor to undertake a complete overhaul of the company's corporate governance and authorizing a group of highly qualified independent consultants to ascertain that the company has fully eliminated the many defects in the company's internal controls detected after a comprehensive review by the company's new outside auditors. The new corporate governance strictures will, among much else, mandate an active, informed, and highly independent board, prohibit related-party transactions and conflicts of interest, require a unique shareholder role in the nomination of directors, and impose significant restrictions on executive compensation packages. Moreover, even though not all of the specific changes in corporate governance and internal controls have yet been formulated, the company has committed in advance to adopt and adhere to all corporate governance and internal control recommendations made by the Corporate Monitor and the independent consultants, subject only to appeal to this Court. * * *

The permanent injunction also requires the company to provide a large segment of its employees with specialized training in accounting principles, public reporting obligations, and business ethics, in accordance with programs being specially developed for the company by New York University and the University of Virginia. At the behest of the Corporate Monitor, the Court also obtained from the new Chief Executive Officer a sworn "Ethics Pledge," requiring, on pain of dismissal, a degree of transparency well beyond [the Commission's] requirements. The company has since required its senior management to sign a similar pledge, and has plans to obtain similar pledges from virtually all employees.

The Court is aware of no large company accused of fraud that has so rapidly and so completely divorced itself from the misdeeds of the immediate past and undertaken such extraordinary steps to prevent such misdeeds in the future. While the Court, at the parties' express request, will continue to retain jurisdiction for however long it takes to make certain that these new controls and procedures are fully implemented and secured, the Court is satisfied that the steps already taken have gone a very long way toward making the company a good corporate citizen.

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[With respect to the agreement] *the Court is satisfied that the Commission has carefully reviewed all relevant considerations and has arrived at a penalty that, while taking adequate account of the magnitude of the fraud and the need for punishment and deterrence, fairly and reasonably reflects the realities of this complex situation.* Undoubtedly the settlement will be criticized by, among others, those shareholders unfamiliar with the severe limits imposed on their recovery by the bankruptcy laws, those competitors whose own self-interest blinds them to the broader range of public policies that such a settlement implicates, and those professed pundits [commentators] and ideologues for whom anything less than a corporate death penalty constitutes an "outrage." But the Court is convinced, for the reasons already outlined above, that the proposed settlement is not only fair and reasonable but as good an outcome as anyone could reasonably expect in these difficult circumstances. [Emphasis added.]

DECISION AND REMEDY *The court approved the agreement between the company's new management and the Securities and Exchange Commission to settle the "monetary penalty phase of this litigation" and issued a judgment to that effect. The parties agreed to pay \$500 million in cash and \$250 million in the company's new stock to be distributed to "qualifying claimants" (creditors).*
