Testimony of

Mr. Mark Neporent

July 22, 2003

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Mark A. Neporent
Chief Operating Officer

Cerberus Capital Management, L.P.

on the Benefit of MCI's Reorganization to Creditors and the Economy

Committee on the Judiciary

United States Senate

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My name is Mark Neporent and I am the Chief Operating Officer of Cerberus Capital Management, L.P. Cerberus, together with its affiliates, manages and has full investment discretion over funds and accounts with committed capital exceeding $9 billion. Cerberus is one of the largest participants in the U.S. distressed debt, distressed securities, and reorganization markets. Cerberus' investors include insurance companies, pension funds, endowments, institutions, wealthy individuals and many fund-of-funds. We have been managing capital in this sector for more than 15 years.

I have been engaged in the business of restructuring and reorganizing companies, both large and small, as a partner in Schulte Roth & Zabel LLP, a large New York City based law firm, and as a principal at Cerberus. Accordingly, I have first-hand experience with the utility of federal bankruptcy law and policy and the delicate balancing of the diverse interests affected by those laws and policies. I am also the co-chairman of the Official Creditors' Committee of WorldCom/ MCI's ("MCI") Chapter 11 bankruptcy case. The Committee, as the statutorily mandated fiduciary representative of all unsecured creditors, represents the various classes of creditors across the MCI corporate structure, with aggregate claims exceeding $40 billion.

MCI's creditors, employees and customers will be best served and protected by adherence to the process envisioned by and incorporated in the Bankruptcy Code. Taking punitive action against MCI, at the behest of its competitors, would undercut the longstanding and successful implementation of the policies underlying the Bankruptcy Code and its role in our economy.

Even before federal bankruptcy law was substantively revised in 1978 with the passage of the United States Bankruptcy Code, two separate and distinct policies have long guided the bankruptcy process in the United States. 1 Those policies consist of a fresh start for financially

distressed companies and equality of treatment of its creditors, large and small. Congress reiterated, and reinforced these policies 25 years ago when it enacted the Bankruptcy Code. 2 These policies, while designed to protect two different (albeit converging) interests, are equally important to the success of the federal bankruptcy regime. Bankruptcy long ago lost its stigma, and is widely recognized, not only in the United States, but in numerous other developed countries that have modeled their bankruptcy laws after ours (i.e., Canada, Japan, Germany), as a legitimate and sometimes necessary corporate strategy in the context of a capitalist system. As noted in a recent news article, "scores of businesses, some of them icons of American industrialism, have gone through bankruptcy and emerged to become strong, vibrant concerns, employing millions and offering consumers a wide variety of desirable goods and services. Texaco, Remington Arms, Continental Airlines, Southland Corporation's 7-11 stores - all have declared bankruptcy and stayed in business." 3

Federal bankruptcy law is designed to favor reorganization rather than liquidation and to provide debtors with a "fresh start" by affording a variety of protections to a company undergoing a reorganization, including the ability to emerge from bankruptcy with a reduced debt load if its creditors agree and certain tests are met. Just as important are the policies of absolute priority (i.e., the statutory hierarchy which dictates the order of payment among creditors and shareholders) and providing creditors a fair and equal opportunity to get paid. Creditors are to be treated the same as every other similarly-situated creditor and are assured that they cannot be forced to take less in a reorganization than they would receive in a liquidation.

The reorganization provisions contained in the Bankruptcy Code take each of these policies into account by providing both debtors and creditors certain rights and protections under the law. Indeed, MCI's bankruptcy case is an excellent example of how these policies are being implemented effectively to take a tragic situation and salvage the maximum possible value for creditors, shareholders, customers, employees and vendors . It is well documented that WorldCom, Inc., MCI, and a number of their affiliates were forced to seek bankruptcy protection in July 2002, largely due to the fraudulent activities of a handful of the top executives of a company that, at the time, employed nearly 75,000 employees. Within a year of the filing of the largest bankruptcy case in U.S. history, all employees even remotely connected to the fraud, and the entire Board of Directors, were replaced. A dynamic new CEO, Michael Capellas, whose integrity is beyond question, has been hired to lead MCI out of the woods. The financial management team has been rebuilt around Robert Blakely, MCI's new CFO, and over 400 new financial personnel. MCI has worked with Richard Breeden, former chairman of the SEC, to shape MCI as a model of good corporate governance. Each of MCI's top 80 executives have signed a comprehensive ethics contract and MCI has adopted a "zero-tolerance" ethics policy firm wide. Within nine months after the filing, representatives of all major creditor constituencies agreed on a reorganization plan. This would be remarkable in any case, and is especially so in the largest bankruptcy case in history.

Since the announcement of its reorganization plan, a number of MCI's competitors have asserted that it should be punished for the crimes of its former executives by either being forced to liquidate or having its ability to service government contracts revoked. This is the functional equivalent of a corporate death penalty - capital punishment of the enterprise for the transgressions of a few rogue executives (who are now being pursued, rightfully so, by the

government and the victims of these executives' fraud). In doing so, those opposing MCI's reorganization are completely ignoring the second fundamental policy of federal bankruptcy law, namely that of protecting the thousands of creditors, including numerous individuals, banks, pension funds, insurance companies, and endowments, not to mention over 55,000 innocent employees who had nothing to do with the fraud.

Overall, Chapter 11 of the Bankruptcy Code is intended to provide a debtor with the opportunity to rehabilitate its business in all respects, to preserve jobs, and to maximize the value for creditors. 4 Forcing MCI to liquidate or otherwise limit its activities or opportunities would not accomplish any of these objectives. Instead, liquidation would cause MCI's extinction, leave 55,000 employees without jobs, negatively impact millions of residential and business customers who rely on MCI for their critical telecommunications needs, dramatically reduce the return to creditors, and adversely affect the competitive balance in the telecommunications sector (which is exactly what MCI's opponents are trying to achieve under the guise of moral high ground). Similarly, limitations imposed on MCI's servicing of government contracts would seriously and unfairly constrict MCI's ongoing operations, not to mention the government's bargaining power with local monopolies and other entrenched competitors. In addition, it would put the success of MCI's plan of reorganization in jeopardy and leave tens of thousands of workers jobless and reduce the anticipated return to creditors, not to mention create certain disruption and massive cost to government operations currently serviced by MCI.

MCI provides services to nearly every federal government agency and to many states, operating some of the most complex and sophisticated network solutions ever deployed. MCI's performance as a government contractor continues to meet and exceed the most exacting standards - it was never affected by the fraud - and its network is unmatched in scope and capability. MCI's service levels are the best in the industry and are continuing to improve. 5

It is beyond doubt that MCI's reorganization plan provides creditors with a much greater chance of recovery than does liquidation, which would literally throw away billions of dollars of value. MCI's going-concern value is estimated to be approximately $12-15 billion, while its liquidation value is only $4 billion. Not surprisingly, representatives of 90% of MCI's debt have quickly and efficiently resolved their internecine differences - exactly as contemplated by the Bankruptcy Code - and have given their support to MCI's proposed reorganization plan.

It is obvious that the only parties who would benefit from MCI's liquidation, elimination of its aggregate viability and value, or restriction of or elimination of its ability to participate in government contracts, are MCI's competitors and the powerful special interest groups that work for these competitors. Neither the provisions of the Bankruptcy Code, nor the policies promulgated thereby, are satisfied by such tactics. Essentially, these competitors and special interest groups are attempting to gain a strategic advantage by seeking MCI's liquidation. The competitors who propose the imposition of the corporate death penalty here have themselves enjoyed decades of unchecked monopolistic advantage as the mega-combinations of the past monopolies. These competitors built their franchises in an environment protected from competition. Now, rather than turn their resources to competition and face MCI head-to-head on the competitive landscape, they seek to eliminate the competition, or at least hamper it severely, with misplaced and misguided attacks on innocent creditors, employees and customers.

The liquidation of MCI or diminution in its services in no way punishes those few individuals responsible for forcing MCI into bankruptcy. These individuals have long since been removed. There has been, at the creditors' insistence and with MCI's cooperation, a full "housecleaning" both in management and of the Board of Directors. Likewise, the destruction of MCI will not benefit creditors, employees, customers, vendors or the public interest. MCI's demise at the hands of its competitors will, instead, directly punish those who are specifically entitled to be protected as a matter of public policy and law by forcing thousands of employees to lose their jobs and thousands of creditors to receive billions less than they would otherwise receive through reorganization - the exact opposite of a fundamental bankruptcy principle of value maximization.

Some have urged that creditors be brushed aside as mere "vultures" and that the old Worldcom/ MCI shareholders who, for the most part, are institutions and not individuals, are the only real victims of the fraud and insolvency. To be sure, the rogue senior executives at WorldCom did mask the true financial picture and held or delayed the disclosure of the information that led to the destruction of the value of WorldCom's equity. However, the reality is that in March 2000 a variety of macroeconomic concerns began to take their toll on the overall telecom market and, ultimately, resulted in an historic three year bear market from which we are only now (maybe) beginning to emerge. These macroeconomic forces led to a decline of over 40% in the Telecom Growth Index, while WorldCom's stock declined approximately 25% over the corresponding period. 6 So, like the stock of virtually every company in the telecommunications sector, WorldCom's stock was already in the process of plummeting at the time the fraud was announced. Shareholders who did not cut their losses by selling during the bear market likely lost most, or all, of their investment.

MCI's fraud did not create the telecom bubble, nor did it pop that bubble. The SEC noted, in presentations to Judge Rakoff at the hearings on the SEC fine and settlement, that shareholders did not give their money to MCI, they gave it to other market participants. 7 MCI "gained" not a dollar from shareholders as a result of its fraud. The same is not true of MCI's creditors. Creditors (the banks and bondholders) lent their money directly to MCI because MCI defrauded them into doing so. MCI gained billions of dollars from creditors whose funds were used to build the business and acquire the assets that MCI's competitors now say should be liquidated. Common sense, not to mention the law, measures damages by the perpetrator's ill-gotten gains. These "gains" came from the creditors, not the shareholders. This fundamental premise is, likewise, recognized in the Bankruptcy Code's distribution hierarchy which requires that creditors be repaid in full before equity holders are entitled to receive anything. 8

Destroying MCI will not benefit the misled shareholders. The shareholders are deep into the process of using the legal system to obtain redress from the perpetrators of the fraud - the handful of rogue executives - rather than the MCI corporate enterprise which is itself a victim of fraud. MCI's creditors are entitled to rely on judicial and legal checks and balances - like adherence to statute and the legislative policies embodied in the federal bankruptcy laws. MCI's adversaries should not be permitted to make an end run around these laws and policies to serve their own parochial interests.

Decades of successful federal bankruptcy policy has been premised upon rehabilitation and reorganization, rather than liquidation, regardless of the cause of insolvency. Under the

Bankruptcy Code, fraud that leads to bankruptcy does not in any way prevent or limit the reorganization of a corporate entity. Indeed, the recently-enacted Sarbanes-Oxley Act of 2002 continued and reaffirmed this policy by permitting corporations to obtain relief under the Bankruptcy Code from claims arising from fraud, while revoking that privilege for individuals who commit certain crimes. 9 This underscores the distinction between individual corporate officers that commit a fraud and the corporate entity that they victimized. This enables the business that was victimized by the criminal activity of its management to be rehabilitated and reorganized.

Further, the SEC has clearly voiced its support of MCI and its future success. 10 Specifically, the SEC sought to put MCI on stable ground and to help it reorganize, thereby preserving thousands of jobs and avoiding disruption of customer service, all while creating a model corporate citizen. In approving the settlement between MCI and the SEC, Judge Rakoff recently found that these efforts had been successful. In fact, the court noted that it was not aware of any large company so thoroughly having "divorced itself from the misdeeds of the immediate past and undertaken such extraordinary steps to prevent such misdeeds in the future." 11

Additionally, Judge Rakoff dismissed the call for liquidation voiced by MCI's competitors, noting that liquidation would "unfairly penalize" MCI's "innocent" employees, "remove a major competitor from a market that involves significant barriers to entry, and set at naught [MCI's] extraordinary efforts to become a model corporate citizen." 12 Further, the court clearly showed its support for the bankruptcy policy of protecting creditors when it stated that liquidation would "unfairly impact creditors" and that it "would undercut the basic tenets of bankruptcy reorganization . . . ," which the court noted have "contributed materially to the conservation of economic resources and the stability of the U.S. economy." 13

Accordingly, successful reorganizations by corporate debtors further national economic stability and growth. Without the ability to reorganize, corporate debtors would be forced to lay off thousands of employees annually, all while minimizing the return to creditors and reducing competition in the marketplace.

MCI's successful reorganization is critical to the nation's economy in that it will further competition and innovation. Consumers must have a robust field of telecom competitors to keep prices in check and to drive the development of new products and services. Without MCI, the telecommunications market would not be very different than it was prior to the breakup of AT&T.

MCI is a remade company prepared to emerge from Chapter 11 as a robust contributor to the global economy. In fact, MCI provides critical communication services for tens of thousands of businesses and government agencies around the world. It carries approximately 30% of the world's Internet traffic, with some of the world's most important financial institutions relying on MCI, including NASDAQ, the London and Stockholm Stock Exchanges, and the Chicago Board of Trade. Additionally, MCI provides key network and infrastructure support for numerous federal government security and service agencies, including, to name a few, the Department of Defense, the United States Navy and Coast Guard, the Federal Aviation Administration, the United States Postal Service, and the Social Security Administration.

MCI's former senior management and directors have been removed and its 55,000 innocent employees are working harder than ever to ensure future success. Federal bankruptcy policy is being fully satisfied and followed in MCI's bankruptcy case as MCI is being afforded an opportunity to reorganize while the value returned to its creditors is being maximized. It is time to move forward. MCI's new management and Board, and my Creditors' Committee, have worked tirelessly for more than a year to provide the building blocks for the emergence of MCI from bankruptcy and a chance to recover some of the billions of dollars lost at the hands of a few dishonest and misguided executives. This Chapter 11 case is an exemplar of how Congress envisioned the Bankruptcy Code to work. I can tell you from two decades of personal experience - it does not often work this well. The Company, its creditors, and the system are to be commended. Accordingly, the self-serving attempts by MCI's competitors to force liquidation find no support in the law, public policy, or common sense and should be dismissed.

Thank you Chairman Hatch and members of the Committee for allowing me to share my views.

Endnotes

1. H.R. REP. NO. 95-595, at 285 (1977) (acknowledging "the two strong bankruptcy policies of a fresh start for the debtor and the equality of treatment of all creditors").

2. "The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors and produce a return for its stockholders. The premise of business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. Often the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors, both trade creditors and long-term lenders, to wait for payment of their claims. If the business can extend or reduce its debts, it can often be returned to a viable state. It is more economically efficient to reorganize than to liquidate because it preserves jobs and assets." Id. at 220. (emphasis added).

3. Richard Lessner, Punishing Innocent Workers, Sacramento Bee, July 14, 2003, at www.sacbee.com.

4. Bankruptcy is not a panacea. Although the commencement of a reorganization case has lost its stigma, the negative impact of a filing can be great. The filing of a reorganization case creates uncertainty with employees, whose loyalty and work ethic are critical to any successful restructuring. It also creates uncertainty with vendors who may be reluctant to provide goods and services for fear of not being paid, or who may impose draconian payment terms to try and protect their interests which adversely effects working capital. Customers may not wish to deal with a bankrupt entity and take their business elsewhere. MCI has experienced more than its share of these consequences, but new management has done a good job restoring confidence in MCI's long-term viability.

5. Based on reportable outages to the FCC in 2002. See chart attached as Exhibit A.

6. See chart attached as Exhibit B. Some of the major macroeconomic forces precipitating the decline beginning in March 2000 included:
a. a perceived slowing in the growth rate of the Internet and data transmissions;
b. a reduction in funding to negative cash flow Internet and technology companies;
c. a surplus of data transmission capacity driven by technology advancements and prior investments in capacity; and
d. a concomitant slowdown in capital expenditures.

7. SEC v. WorldCom, Inc., No. 02 Civ. 4963, Tr. of Hearing 27 (S.D.N.Y. June 11, 2003) (comments of SEC).

8. Despite the clear statutory distribution priority, the Creditors' Committee, out of a sense of moral fairness approved a radical and voluntary departure from the priority and has consented to $750 million of value being distributed to security holders under MCI's plan of reorganization.

9. Sarbanes-Oxley Act of 2002, PL 107-204, § 803, 116 Stat 745 (2002).

10. SEC v. WorldCom, Inc., No. 02 Civ. 4963, 2003 WL 21523992 at **2-3 (S.D.N.Y. July 7, 2003) (approving MCI settlement with SEC).

11. Id. at 5.

12. Id. at 6-7.

13. Id. at 7.