

Testimony of
Mr. Richard Thornburgh

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Statement of Dick Thornburgh, WorldCom Bankruptcy Examiner,
Before the Senate Committee on the Judiciary
Tuesday, July 22, 2003

Chairman Hatch and members of the Committee:

I appreciate this opportunity to appear before you today in connection with my responsibilities as the Examiner in the WorldCom bankruptcy proceedings - the largest bankruptcy in United States history. To date, my examination, which began in August 2002 and continues today, has resulted in two interim reports detailing my observations concerning the conduct of WorldCom management and others affecting the operations of the Company. I anticipate filing a third report this fall. Today, I intend to summarize for you the observations contained in my first and second interim reports, as well as describe the examination process.

On July 21, 2002, WorldCom and substantially all of its direct and indirect subsidiaries filed voluntary petitions seeking relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. These petitions came just four weeks after the Company publicly disclosed on June 25, 2002 that it had discovered substantial accounting irregularities that would result in adjustments to its financial statements totaling more than \$3.8 billion. The Company restated an additional \$3.3 billion in August 2002. Still further adjustments were announced by the Company earlier this year and now appear to be on the order of \$11 billion in total.

The day after WorldCom filed its bankruptcy petitions, Judge Arthur J. Gonzalez, the presiding Bankruptcy Court Judge, granted the motion of the United States Trustee for the appointment of an Examiner pursuant to Section 1104(c)(2) of the Bankruptcy Code. On August 6, 2002, the Court approved my appointment as Examiner. The Court's Order provides that the Examiner "shall investigate any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in the management of the affairs of [WorldCom] by current or former management, including but not limited to issues of accounting irregularities." The Court also directed me to coordinate with the United States Department of Justice, the United States Securities and Exchange Commission ("SEC") and other federal agencies investigating matters related to WorldCom to avoid duplication of effort. Further, the Court ordered me to file a report regarding my examination within 90 days of my appointment.

Upon my appointment, I promptly engaged professionals to assist me in discharging the broad mandate prescribed by the Court. I engaged my law firm, Kirkpatrick & Lockhart LLP, as my legal counsel. I also engaged J.H. Cohn LLP, as my forensic accountants and financial advisors. My professionals and I immediately set out toward our goal of assessing thoroughly, objectively, and responsibly the acts and omissions of current and former management, as well as the integrity of WorldCom's management, its accounting and financial reporting processes and its corporate governance practices and internal controls.

Our investigation has been, and continues to be, multi-faceted. We have reviewed millions of

pages of documents received from numerous sources and conducted or participated in scores of interviews of persons with relevant information. Our document collection efforts and interviews continue today. I am pleased to acknowledge the cooperation of WorldCom and its counsel regarding these matters. I also acknowledge with appreciation the assistance provided by the Honorable Richard C. Breeden, the Corporate Monitor appointed by the United States District Court for the Southern District of New York in a proceeding commenced by the SEC against WorldCom. Further, in an effort to avoid unnecessary duplication of effort and expense, I note that we have maintained an active dialogue regarding matters related to our examination with counsel and financial advisors for the Official Committee of Unsecured Creditors in the bankruptcy proceedings, as well as a Special Investigative Committee of the Company's Board of Directors and its professionals, and KPMG LLP, the Company's current outside auditors. Consistent with the Court's initial directive, my professionals and I also have coordinated extensively with the Department of Justice, the SEC and other agencies that are investigating matters related to WorldCom. We have refrained from publishing certain findings or results of our investigation in deference to these ongoing prosecutorial and regulatory inquiries whom these agencies have represented to us that such disclosures may adversely affect the process of determining possible criminal or other wrongdoing by persons involved in these matters. Mr. Chairman, I respectfully request that you and other members of the Committee respect my inability to discuss these matters at today's hearing because of the related law enforcement and regulatory concerns. Similarly, I feel it would be inappropriate for me to discuss our ongoing fact-gathering efforts because any such comments may have a detrimental impact on our investigation. Accordingly, I intend to confine my remarks this afternoon to matters that have been addressed in my first and second interim reports of examination, which are a part of the public record.

As I stated earlier, the Court initially directed that I file a report of examination within 90 days of my appointment. Pursuant to that directive, I filed my First Interim Report in a timely manner on November 4, 2002. The initial 90-day period obviously did not permit me the time necessary to explore all matters related to the conduct of WorldCom management. In addition, as I stated a moment ago, we omitted from the First Interim Report certain details - particularly items related to the specifics of the Company's accounting fraud - in deference to ongoing prosecutorial and regulatory interests. Therefore, the observations set forth in my First Interim Report were preliminary in nature. Nonetheless, as described in that Report, a picture had already begun to emerge regarding the deeply problematic culture and lack of corporate controls at WorldCom. After I filed my First Interim Report, my professionals and I continued our investigative efforts to advance the preliminary observations contained in the First Interim Report. My Second Interim Report, filed June 9, 2003, summarized my observations based upon this additional investigation. As stated in that Report, the WorldCom story is not limited to the massive accounting fraud that has been publicly reported. We uncovered additional deceit, deficiencies, and a disregard for the most basic principles of corporate governance. My observations in that Report reflect a broad breakdown of the system of internal controls, corporate governance and individual responsibility, all of which worked together to create a culture in which all too few individuals took responsibility until it was too late.

Our investigation reflects that WorldCom was dominated by Bernard Ebbers and Scott Sullivan, its former Chief Executive Officer and Chief Financial Officer of the Company, respectively, with virtually no checks or restraints placed on their actions by the Board of Directors or other management. Significantly, although many present or former officers and directors of WorldCom

told us that they had misgivings regarding decisions or actions by Mr. Ebbers or Mr. Sullivan during the relevant period, there is no evidence that these officers and directors made any attempts to curb, stop or challenge the conduct by Mr. Ebbers or Mr. Sullivan that they deemed questionable or inappropriate. Instead, as described in my Reports, it appears that the Company's officers and directors went along with Mr. Ebbers and Mr. Sullivan, even under circumstances that suggested corporate actions were at best imprudent, and at worst inappropriate and fraudulent.

There are many specific corporate governance failings identified in my First and Second Interim Reports. I will highlight only a few examples for you this afternoon. First, we observed no meaningful deliberative processes related to the Company's acquisitions. As stated in my Reports, WorldCom's dramatic rise in stock value throughout the fifteen years preceding its bankruptcy fueled numerous acquisitions that caused the Company to grow tremendously in both size and complexity in a relatively short amount of time. The Company's approach to such acquisitions was ad hoc and opportunistic. Acquisitions were completed with little meaningful or coherent strategic planning. WorldCom management routinely provided the Company's directors with extremely limited information regarding many of those acquisitions. In fact, several multi-billion dollar acquisitions were approved by the Board of Directors following discussions that lasted for 30 minutes or less and without the directors receiving a single piece of paper regarding the terms or implications of the transactions. Significantly, although persons involved with the Board's consideration of some of these matters informed us that they were disturbed at the time, no director or anyone else voiced any objection to cursory considerations by the Board. Second, the Company's lack of internal controls infected its debt offerings and use of credit facilities. Indeed, there is no evidence that WorldCom management or the Board of Directors reasonably monitored the Company's debt level or its ability to satisfy its outstanding obligations. Messrs. Ebbers and Sullivan had virtually unfettered discretion to commit the Company to billions of dollars in debt obligations with virtually no meaningful oversight. WorldCom issued more than \$25 billion in debt securities in the four years preceding its bankruptcy. With respect to such offerings, Messrs. Ebbers and Sullivan comprised the entirety of the Company's Pricing Committee. The Board passively "rubber-stamped" proposals from Messrs. Ebbers or Sullivan regarding additional borrowings, most often via unanimous consent resolutions that were adopted after little or no discussion.

It seems clear that WorldCom's ability to borrow monies was facilitated by its massive accounting fraud, which allowed the Company to falsely present itself as creditworthy and "investment grade." It also seems clear that the Company's ability to borrow vast sums allowed it to perpetuate the illusion of financial health created by its accounting fraud. As late as a few weeks before it disclosed its massive accounting irregularities, WorldCom used false financial statements to access all of a \$2.65 billion line of credit, the proceeds of which it used to pay down another credit facility. As the Company's Treasurer told us in an interview, WorldCom merely "robbed Peter to pay Paul."

Third, our investigation raises significant concerns regarding the circumstances surrounding the Company's loans of more than \$400 million to Mr. Ebbers. As detailed in my Reports, the Compensation and Stock Option Committee of the Board of Directors agreed to provide enormous loans and a separate guaranty for Mr. Ebbers without initially informing the full Board or taking appropriate steps to protect the Company. Further, as the loans and guaranty increased, the Committee failed to perform appropriate due diligence that would have demonstrated that the collateral offered by Mr. Ebbers was grossly inadequate to support the Company's extensions of

credit to him, in light of his substantial other loans and obligations. Our investigation reflects that the Board was similarly at fault for not raising any questions about the loans and merely adopting the actions of the Compensation Committee.

I believe the loans to Mr. Ebbers are troubling for an additional reason. These extraordinary loans highlighted the extent of Mr. Ebbers' business activities that were not related to WorldCom. In my view, the Board should have questioned whether these non-WorldCom business activities were consistent with the need for Mr. Ebbers to devote his time and attention to managing the business of such a large and complex company as WorldCom. However, it appears that the Board did nothing to attempt to persuade Mr. Ebbers to divest himself of his other businesses or otherwise limit his non-WorldCom business activities. To the contrary, the Compensation Committee and the Board provided the massive funding that facilitated Mr. Ebbers' personal business activities.

Finally, the fact that WorldCom's accounting irregularities went undetected for so long provides further testament to the inadequacy of the Company's systems of internal controls. The Audit Committee of the Board of Directors and the Internal Audit Department appear to have acted in good faith. To their considerable credit, they took significant and responsible steps once accounting irregularities were discovered in the spring of 2002. Nonetheless, it seems abundantly clear that the Audit Committee over the years barely scratched the surface of any potential accounting or financial reporting issues. Moreover, the Internal Audit Department adopted an operational audit function; that is, it focused its efforts on efficiency and cost-savings concerns, rather than acting as WorldCom's "internal control police." Finally, it appears that the Audit Committee, the Internal Audit Department, and Arthur Andersen, the Company's former outside auditors, allowed their missions to be limited and shaped by Mr. Sullivan in ways that served to conceal and perpetuate the Company's accounting fraud.

All told, I believe that WorldCom's conferral of practically unlimited discretion upon Messrs. Ebbers and Sullivan, combined with passive acceptance of management's proposals by the Board of Directors, and a culture that diminished the importance of internal checks, forward-looking planning and meaningful debate or analysis formed the basis for the Company's descent into bankruptcy. In many significant respects, WorldCom appears to have represented the polar opposite of model corporate governance practices during the relevant period. Its culture was dominated by a strong Chief Executive Officer, who was given virtually unfettered discretion to commit vast amounts of shareholder resources and determine corporate direction with only minimal scrutiny or meaningful deliberation or analysis by senior management or the Board of Directors. The Board of Directors appears to have embraced suggestions by Mr. Ebbers without question or dissent, even under circumstances where its members now readily acknowledge they had significant misgivings regarding his recommended course of action.

Although the absence of internal controls and the lack of transparency between senior management and the Board of Directors at WorldCom does not directly translate to the massive accounting fraud committed by the Company, I believe that these corporate governance failings fostered an environment and culture that permitted the fraud to grow dramatically. A culture and internal processes that discourage or implicitly forbid scrutiny and detailed questioning can be a breeding ground for fraudulent misdeeds. They also can beget ill-considered and wasteful acquisitions, improperly managed and unchecked debt and poor credit management, a lack of due diligence regarding personal loans made by the Company to its Chief Executive Officer, and an effective neutering of other gatekeepers, such as the lawyers, the Internal Audit Department and the Company's outside auditors. In tandem with the accounting irregularities, these

developments fostered the illusion that WorldCom was far more healthy and successful than it actually was during the relevant period. Ultimately, they also produced the largest bankruptcy in the history of the United States.

With that, Mr. Chairman, I will conclude my introductory remarks. I thank you for the opportunity to address the Committee this afternoon. With your permission, I will offer the summary sections of my First and Second Interim Reports, which outline more fully my observations based upon our investigation, to be entered into the record as a supplement to my statement.