

Testimony of  
**Mr. William Barr**

July 22, 2003

TESTIMONY OF WILLIAM P. BARR, GENERAL COUNSEL OF VERIZON  
AND FORMER UNITED STATES ATTORNEY GENERAL,  
BEFORE THE SENATE JUDICIARY COMMITTEE  
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Thank you for inviting me to appear at this hearing. My message today is a simple one: The federal government's response to date to the massive fraud committed by MCI is one of the most shameful episodes I have witnessed in Washington since starting my career in public service more than 25 years ago. MCI committed the largest securities fraud in American history, falsely manufacturing more than \$11 billion in income. Investors lost roughly \$180 billion--more than three times the losses in Enron--and MCI's brazen scheme dramatically deepened the crisis of confidence in corporate America, imposing incalculable costs across the whole economy. In response, the federal government has taken several affirmative steps--not to punish MCI, or to strip away the gains from its fraud, or to ensure that full restitution is paid to the tens of thousands of pensioners and companies victimized by the fraud--but to resuscitate the company from its self-inflicted wounds by giving it a series of artificial advantages over law abiding competitors.

None of these giveaways is mandated by the bankruptcy code, through which MCI is seeking to effectuate its resurrection, or by any other law. Rather, these bail-outs are contrary to the letter and spirit of numerous federal statutes, including the securities laws, the tax code, and the laws governing the expenditure of public funds on government contracts. Companies that compete with MCI--such as Verizon, AT&T, SBC, BellSouth, and many smaller companies--have already paid a high price as victims of MCI's fraud. Going forward, we are all ready to compete for customers with anyone on an honest playing field. What we object to--and what should offend this Committee's most basic sense of justice--is that MCI is being rewarded, given massive advantages over competing firms, for bilking pensioners and employees out of their life savings, and being allowed to continue exploiting its fraud at the expense of the employees and shareholders of law-abiding companies. This action can only have dire effects for the economy--which depends on the telecommunications sector as an engine of growth--for public confidence in American financial markets, and for the rule of law.

#### The Precedence of Law Enforcement Over Bankruptcy

MCI and its apologists within the government completely misrepresent this matter as one governed by MCI's rights in bankruptcy. They seem to believe that the public-policy priority is conserving the company's assets and ensuring its rapid emergence from bankruptcy, and that any actions that do not support these objectives somehow violate MCI's rights in bankruptcy. The government is thus stumbling all over itself to tailor its enforcement response to further the particular bankruptcy result preferred by MCI.

This is a perversion of the law and the government's role. In cases where no crime has been committed, bankruptcy gives priority to creditors. But when a crime has been committed, the

interests of law enforcement take precedence over the commercial default rules of bankruptcy. The government's interest is not in preserving the assets accumulated by a criminal enterprise, but in securing the disgorgement of all ill-gotten gains. The government's actions must be directed not only toward vindicating the interests of creditors, but toward securing restitution for all victims, including shareholders and other actors in the marketplace. Otherwise, bankruptcy becomes a money-laundering machine, giving criminal corporations a blank check to keep stolen property merely because they invoke its protection.

It is the government's obligation to use its law enforcement powers--including disgorgement, restitution, and punitive fines--to bring justice to all of MCI's victims. Its policy of avoiding any conflict with MCI's goals in bankruptcy is a transparent subversion of the public interest to the private interests of MCI. We are not here today because an economic downturn caused a deterioration in MCI's business. Nor are we here because MCI failed to execute its business plan. We are here because MCI committed the largest white collar crime in American history--defrauding more hard-working people out of more money than any company before it. The government has no basis to abdicate its law enforcement authority merely because the enormity of MCI's fraud caused the company to crumble.

#### The SEC Allows MCI to Keep the Fruits of its Fraud

MCI's fraud was massive, whether measured by its scope, duration, or brazenness. The SEC's former economist, Robert Comment, estimated that MCI secured roughly \$18.4 billion in "ill-gotten gains from its accounting fraud." As former Attorney General Thornburgh explained in two interim reports on the fraud, MCI reaped these gains by engaging in a "concerted program of manipulation" over a period of years, extending even beyond "the massive accounting fraud that has been publicly reported." The investigation into MCI's wrongdoing is ongoing, and no one has yet heard "the entire or final story" of malfeasance at MCI.

Nonetheless, the SEC has closed the books on MCI's fraud, bringing its enforcement action against the company to a close with a fine totaling \$750 million. This paltry disposition imposes no punishment whatsoever on MCI, and, more importantly, allows the company to keep as much as 95 percent of the ill-gotten gains it secured through fraud.

That this result gives MCI an artificial advantage over its honest competitors--who were already the company's victims--is obvious. MCI's fraud was so massive that a significant part of its business today--its assets, customers, and market position--are the fruit of its unlawful conduct. MCI used its fraudulently inflated stock to gain strategic advantages through acquisitions, and its reporting of false results undermined the ability of competitors to raise capital and make investments. The SEC's disposition, which allows MCI to keep virtually all of the gains it obtained through fraud, blesses MCI's continuing operation with the balance sheet of a criminal enterprise--putting MCI in the same position as if it had robbed a bank, plowed the proceeds into its business, and gotten away scot-free.

A simple analogy sharpens the point. Imagine two competing trucking firms. One is an honest business, leasing trucks and making payments on time. The other is a criminal enterprise, which acquires its trucks through theft and uses this illicit advantage to steal business from the honest firm. There are two classes of victims--those whose property is directly stolen, and those whose businesses are injured by the criminal enterprise's illicit advantages.

What must the government do to right this wrong? Obviously, the individuals who stole the trucks should be punished, but just as obviously this alone does not remedy the offense. If new management is simply allowed to take over the corrupt company, keeping and using stolen trucks, the law-abiding competitor will still be a victim. It will lose customers and profits, not

because it was beaten in the marketplace, but because it must compete against an enterprise built on criminal activity.

So too with MCI. Under the SEC's settlement, MCI is allowed to profit from its fraud, and competing firms will continue to be the victims of a massive crime. The fact that the new owners will be MCI's creditors--themselves victims of the fraud--does not justify allowing those new owners to exploit MCI's ill-gotten gains. It is patently unjust to reward one set of victims by offering them the opportunity to "cash in" on the crime at the expense of another set of victims. The SEC has tried to defend its settlement by claiming that the fine imposed on MCI is the largest it has ever imposed. This is a sound bite, not a rationale. Every other case the SEC has handled before this one pales in comparison. It's obvious that MCI deserves the largest fine ever, because MCI perpetrated the largest fraud ever investigated by the SEC.

The question is, how large should the fine have been? Michael Milken paid \$600 million--roughly equal to MCI's fine in today's dollars--for an offense that pales in comparison to the fraud committed by MCI. In MCI's case, the irreducible minimum of the SEC's enforcement obligation was to remediate the effects of the company's fraud by compelling disgorgement of all ill-gotten gains and preventing any continuing injury to victims. The SEC's settlement with MCI does not live up to the most basic obligation of our justice system--to ensure that "crime does not pay."

#### MCI's Tax-Avoidance Scheme

Compounding the SEC's failure to deny MCI the fruits of its fraud, the government has failed to block MCI's effort to avoid the payment of taxes on any profits it earns once it emerges from bankruptcy. Even though MCI is using its bankruptcy to shed more than \$20 billion in debt, it is using a shell game to retain approximately \$10-15 billion in net operating losses incurred while the company claimed it was profitable. As a result, MCI will potentially be able to escape the payment of billions of dollars in taxes.

This is a gross injustice. When MCI's honest competitors earn profits, they have to pay taxes. If MCI earns profits after it emerges from bankruptcy, they will for years be tax-free. American taxpayers will be forced to subsidize the worst corporate criminal in history, and MCI will perpetuate the harms caused by its fraud at the expense of every telecommunications company that plays by the rules. This is a brazen attempt to circumvent the existing tax code. And although Senators Santorum and Conrad have introduced legislation to ensure that MCI does not succeed in pulling off this scheme, no enforcement agency has moved to forestall MCI's gratuitous and despicable effort to cheat the Treasury--and its competitors--out of billions of dollars.

#### MCI's Avalanche of Government Contracts

Finally, the government has moved to subsidize MCI by granting the company a growing stream of lucrative contracts. In 2000, during the height of MCI's fraud, the company only did \$122 million in business with the government. Today, that figure has grown to more than \$1.2 billion--meaning that MCI has multiplied its government business by ten times since committing its fraud. MCI is now one of the ten largest government contractors, and has won almost every telecommunications contract awarded in the past year. MCI even secured a no bid contract to build a wireless telephone network in Iraq, notwithstanding the fact that MCI does not sell wireless service and has no expertise in building wireless networks.

By directing these tax dollars to MCI, the government--in particular the General Services Administration--has flouted the clear-cut mandate of the law, which provides that a firm cannot do business with the government unless it can affirmatively demonstrate a "satisfactory record of

integrity and business ethics." That MCI does not meet this standard is obvious to everyone but the GSA, given the magnitude of MCI's unprecedented fraud and what former Attorney General Thornburgh described as a pervasive "culture that permitted . . . fraud . . . and ultimately propelled the Company's descent into bankruptcy."

Almost 30,000 firms and individuals have been suspended or debarred from government contracts, confirming the fact that doing business with the government is not a right, but a privilege. Enron was suspended promptly after its fraud was announced, and others have been debarred for improprieties relating to amounts as little as a few hundred dollars. Under pressure from Senator Collins, the GSA has only just begun to inquire into MCI's fitness to contract with the government, but has not, and apparently is not, undertaking any examination into the nexus between MCI's fraud and its ability to underbid competitors. Thus, the company that General Thornburgh described as "the poster child for corporate governance failures," and which the SEC itself called "one of the ultimate symbols of corporate corruption," continues to be kept afloat with hundreds of millions of tax dollars sent to Washington by the very same people defrauded by MCI.

As bad as MCI's fraud was, it would be a greater injustice if the government were to participate as an accessory after the fact. What the government seems to be saying is that it is willing to ignore MCI's massive fraud and prop up the company as long as MCI continues to give the government a good price. Instead of serving as the protector of society, the government has become a "fence" for stolen goods.

The Claims of MCI's Apologists

MCI's apologists in the government--particularly the SEC--have offered four justifications for their abject capitulation to the largest corporate criminal in American history.

First, the SEC claims that, because MCI is now in bankruptcy, its paltry recovery is the best it can do using its civil enforcement authority. The SEC argues that if it sought a larger recovery for MCI's defrauded shareholders, it might push MCI into liquidation. In the event of liquidation, the SEC asserts, it might not recover anything because civil claims--even the government's--are assigned a low priority. No matter how unfair, the SEC reasons, it is better to accept the scraps from MCI's table than be stiffed altogether.

This is sophistry. For one thing, it is clear that MCI can afford to pay a much larger penalty before facing any risk of liquidation. The average ratio of debt to sales in the telecommunications industry is 85 percent. But based on the numbers it released with its reorganization plan, MCI will emerge from bankruptcy with a ratio of just 22 percent--the lowest in the industry by far. MCI also has roughly enough cash on hand to make the states whole for all of the pension-fund losses they suffered as a result of the fraud. In other words, MCI has the financial wherewithal to pay a fine that begins to approach the magnitude of its ill gotten gains and pays meaningful restitution to its victims. The SEC's disposition not only leaves MCI with the fruits of its fraud, but in the best competitive position in the entire sector.

The SEC's argument is also wrong as a matter of law. The gravamen of the SEC's position is that its civil enforcement powers are inadequate to secure a just disposition. But Congress has specifically provided that, where civil remedies are inadequate, the SEC is authorized to refer a securities fraud case to the Justice Department for all "necessary criminal proceedings." This is not just a question of punitive action, but of using the remedial tools available to the Justice Department, which is expressly empowered to force full disgorgement of all ill gotten gains and set up a fund to compensate victims for their losses. These remedies cannot be avoided in bankruptcy.

The SEC has thus abdicated its most basic responsibility. Rather than affirmatively referring the case to the Justice Department for a fair disposition, it has acted as a cheerleader for MCI's efforts to blow past any enforcement, touting its slap-on-the-wrist settlement as "sufficiently tough to deter future violations of the federal securities laws." This doesn't pass the red-face test. Second, MCI's apologists assert that the company deserves credit for cleaning up its act--that those involved in the fraud are gone and that MCI is "on its way to transforming itself" into "a good corporate citizen." Even if true, this line of argument is totally irrelevant to the issue at hand. Enforcement has two goals--not just punishment, but also remedying the effects of wrongdoing. The extent of rehabilitation is only relevant to what punitive enforcement action should be taken; it has no bearing at all on what remedial enforcement action is necessary. No level of cooperation or rehabilitation can justify allowing a perpetrator of fraud to keep its ill gotten gains.

Even as to punitive action, the claim that cooperation or rehabilitation is sufficient to spare a corporation from punishment is fundamentally pernicious to the administration of justice. It is always the case that individuals commit corporate crimes. If firms could evade punishment merely by sacking the perpetrators and aiding the government in their prosecution, corporations would never be indicted. The law provides for the punishment of corporations precisely because they can do disproportionate injury to the public if they commit a crime. No individual could have pulled off a fraud of the magnitude committed by MCI. Corporations are therefore required to police themselves, and if those efforts fail in as spectacular a fashion as they did at MCI, the corporation must be punished. Any other result eliminates the possibility of deterrence.

Cooperation and rehabilitation may therefore be relevant to the degree of penalty imposed on MCI, but they do not speak to the necessity of corporate punishment.

In any event, while the SEC has been mouthing the mantra of MCI's rehabilitation for eight months, events continue to demolish the claim. MCI's outside auditor recently concluded that the company's much ballyhooed reforms were insufficient and that fraud may still "occur and not be detected." Likewise, the Thornburgh report documented a "culture" of corruption not confined to "a limited number of individuals," and identified "a growing number of problematic issues" matching MCI's known fraud "in their egregiousness, arrogance, and brazenness." MCI itself has revised the estimates of its fraud three separate times, and the company still cannot produce audited financial statements. And the day after MCI's new CEO assured the public that "[n]o one even arguably associated with the past wrongdoing continues to work at the company," MCI's general counsel and treasurer were forced to resign. The spectacle of the SEC falling all over itself to vouch for the integrity of this company is appalling.

Moreover, MCI's cooperation results from necessity, not probity. The fraud here was so egregious that the company had no choice but to cooperate. If this kind of "desperation cooperation" were rewarded with a slap on the wrist, the most brazen violators of the law would escape scot-free, while those with the temerity to raise a legitimate defense would suffer the harshest punishment. This result cannot be squared with any rational concept of justice.

Finally, MCI's apologists claim that appropriate enforcement action would "unfairly damage the company's creditors" and would put "the 55,000 employees of WorldCom . . . out of work."

While this argument seems to have persuaded Judge Rakoff to approve the SEC's settlement, it's a bugaboo. Telecommunications is a volatile and risky industry in which no one's job is guaranteed. MCI itself has already laid off more than 25,000 workers since its fraud was announced. What presents a massive risk to jobs is the government's campaign to subsidize MCI at the expense of honest competitors. More than 650,000 people are employed by other firms in

the telecommunications sector. Giving MCI a host of artificial advantages is not required to sustain its operations and puts the jobs of honest competitors at risk.

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Fortunately, the Department of Justice has not yet completed its investigation into the fraud at MCI. The Department has the tools at its disposal to ensure the complete disgorgement of MCI's ill-gotten gains, and to set up a fund to compensate MCI's victims. Moreover, the Department's guidelines make clear that this is the quintessential case for corporate prosecution, given the magnitude of the crime, the number of high-level executives involved, the pervasive culture of fraud, and the total breakdown of internal controls. Left to its own devices, it is hard to imagine that the Department will not take appropriate enforcement action. If corporate prosecution is not called for in this case, it hard to imagine a case where it would be.

The danger is that the capitulation to MCI by other offices of government, including the SEC and GSA, will create a climate of accommodation--a climate perhaps fostered by a political decision to prop up MCI regardless of the costs. This hearing is therefore quite timely, because it affords the Committee an opportunity to support the Justice Department's effort to make a decision in this case based only on a fair and reasoned application of the law.

The enforcement of our criminal and securities laws always takes precedence over bankruptcy. Bankruptcy is a refuge for honest companies that failed in business, not for a criminal enterprise that collapsed under the weight of its own deceptions. What MCI's competitors want--and what the American public wants--is justice. Honest competition is good for shareholders, for employees, and for consumers. Dishonest competition--competition where the government places its thumb on the scale by giving affirmative advantages to corporate criminals--kills investment, kills jobs, and kills economic growth. More importantly, it undermines the rule of law, which is the cornerstone of our freedom and prosperity.