

Testimony of
Mr. Nicholas Katzenbach

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WRITTEN STATEMENT OF

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INDEPENDENT MEMBER OF THE MCI BOARD OF DIRECTORS,

HEARING ON

"THE WORLDCOM CASE:
LOOKING AT BANKRUPTCY AND COMPETITION ISSUES"

BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

JULY 22, 2003

Chairman Hatch, Senator Leahy, and members of the Committee:

My name is Nicholas Katzenbach, and I serve as an independent member of MCI's Board of Directors. I served as the Attorney General of the United States from 1964 to 1966. Since leaving public service, I have been practicing law - including serving for 17 years as Senior Vice President and General Counsel of IBM.

I joined the Board of MCI on July 21, 2002, almost exactly a year ago, to serve as an independent watchdog who could represent the interests of investors and who could provide a fresh perspective on the operations and management of the company. Dennis Beresford, former chairman of the Financial Standards Accounting Board, joined me on the Board at that time and C.B. Rogers, who has wide experience as a corporate director, later joined us. Together, the three of us comprised the Special Investigative Committee of the Board that was charged with overseeing an independent investigation of the financial irregularities that occurred at WorldCom.

None of us was affiliated with the company in any way during the late 1990s, when MCI was

taken over and was being operated by the former management of WorldCom. Nor were any of us affiliated with the firm when those WorldCom executives - all of whom have now been dismissed from the firm - perpetrated the largest financial fraud in American history.

As someone who has been involved in cleaning up the damage inflicted on MCI during the WorldCom era, I believe I can offer this Committee a perspective on MCI that is quite different from the viewpoints of some other witnesses from whom you'll be hearing today.

I'd like to begin by asking those who would inflict further pain on MCI: Who is it, exactly, whom you intend to punish? Is it the 55,000 employees of MCI, who have already seen their jobs put at risk and their retirement savings driven toward oblivion? Or is it the creditors of the company, who have already seen the value of their investment plummet? Or is it the victims of WorldCom's fraud who - because of our settlement with the SEC - now have a stake in the future success of MCI? Or is it the nation's long-distance telephone customers, who would surely see their phone bills rise and see their service suffer if MCI were to be driven out of business? Nothing that MCI's opponents suggest would hurt the already-departed and already-disgraced senior management of WorldCom, who were ousted and replaced after the fraud was discovered. The draconian punishment advocated by MCI's opponents would, at best, be a futile gesture - and, at worst, would inflict further pain on the innocent.

Mr. Chairman, I'd like to tell you about MCI as I've come to see it - and about the clean break that the company's new management has made with the practices of the past. The company has been transformed: The old WorldCom no longer exists. In its place is a reformed, restructured, realigned company - MCI - that is focused not on the past but on the future.

Under our new Chairman, President and Chief Executive Officer, Michael Capellas, MCI is determined to return to the high standards of ethics, innovation and vigorous competition that had marked the first decades of MCI's existence - the years before WorldCom took over our company.

Let there be no misunderstanding of our position - or of our rigorous focus on corporate integrity. The behavior of the former WorldCom executives, who were responsible for the accounting fraud at the company, is indefensible. The company was right to force these executives out, and it was right to blow the whistle on itself and on its internal problems. We will continue to cooperate completely with all of the various investigations, criminal and civil, that are looking into this past misconduct.

Let me also assert, Mr. Chairman, that I take vigorous exception to some of the allegations that have been made in recent days, and are being offered to this Committee today, about the character of the newly restructured MCI. I feel compelled to call the Committee's attention to the motivation behind some of those from whom you'll be hearing testimony today. Some of MCI's critics are calling for MCI to be barred from competing for federal contracts; to be hobbled in competing in the open marketplace; and to be broken up as a corporation, allowing its assets to be auctioned off to the highest bidder.

Mr. Chairman, MCI today is being attacked by the very same telecommunications behemoths that have always resented MCI's role as a vigorous marketplace competitor. Those industry giants have always tried to impede the creation of a level playing field. MCI's history has been one of fighting against monopolies and fighting for market innovation. Throughout its 30-year history, MCI's performance has proven the virtue of open competition. We have provided lower rates to long-distance customers; we have innovated with new and higher-quality services; we have offered customers a broad range of new service options; and we have led the industry in improving standards of customer service. For 30 years, we have proven our value as a competitor

in the marketplace.

Yet like any innovator that seeks to break up cozy, long-established monopolies, MCI has inspired relentless opposition from its business rivals. By their very nature, monopolies and oligopolies don't like a level playing field, because they seek to suppress competition. At every turn, AT&T and the Regional Bell Operating Companies have sought to re-establish and reinforce their comfortable positions of dominance. And they have fought bitterly to impede MCI in its effort to innovate.

We should thus have no illusions about the one-sided information being propounded today by AT&T and the Baby Bells. Let us recognize their strident demands for what they truly are: An opportunistic business tactic to enlist support for their ultimate goal - driving MCI out of business. Our detractors are not acting in the spirit of the public interest: They are arguing a case in their own self-interest. Their arguments are driven by the economic benefits that they, themselves, may gain from politicizing this battle.

Mr. Chairman, let me submit to you: Our rivals are attempting to use political and regulatory means to quash MCI, because they know that they cannot win this fight in the open marketplace. In fact, Mr. Chairman, it is especially interesting to note that one of the Regional Bell Operating Companies - one of the most strident voices attacking us today - actually approached MCI in 2001, offering to buy our company. The offer was rejected, and the company chose to remain an independent competitor. Now, like a spurned suitor, that Bell company seeks to win by political maneuvering what it could not win directly. By seeking a breakup of MCI, that rival aims both to eliminate a competitor and to scoop up our assets at a bargain-basement price - thus solidifying its dominant position in the marketplace, and reinforcing its quasi-monopoly. Such tactics are profoundly antithetical to consumers' interests and to the public good.

Worse, those who would put MCI out of business would punish those who have surely suffered enough already: the 55,000 innocent employees of MCI. Those dedicated, highly skilled employees have already seen their career prospects damaged, simply by their association with the WorldCom fraud; they have already seen their stock options become worthless; they have already seen the value of the company stock in their 401 (k) plans wither. And now they are living under the threat of additional job losses - amid our nation's prolonged recession, when jobs are already scarce - as the rival long-distance firms and the Baby Bells contrive to undermine their company. This final indignity, inflicted by our rivals, is an injustice to our employees and to their hard work.

MCI is restructured, realigned and ready to compete. As we anticipate our emergence from bankruptcy protection this fall, let me describe, Mr. Chairman, the steps that MCI has taken to demonstrate its good will; to reform its corporate governance structure; to strengthen its internal safeguards against any wrongdoing in the future; and to enhance the quality of its operations. First, our efforts to overcome the legacy of misconduct. When MCI discovered evidence of the WorldCom leadership's accounting fraud, the company responded immediately. The company immediately brought the fraud to the attention of governmental authorities. The Board fired the CFO, and the board accepted the resignation of the Controller and other implicated accounting personnel. MCI has cooperated with all investigations, has submitted tens of thousands of documents, and has facilitated dozens of interviews of company personnel. Immediately after the fraud was discovered, the Special Committee of our Board directed that an independent investigation be conducted and a report be developed to determine the facts and causes of the fraud. As part of these investigations, personnel involved in fraudulent activity or otherwise associated with inappropriate conduct have been separated from the company. The company has

also cooperated with a separate investigation led by an examiner appointed by the United States Bankruptcy Court.

Second, our efforts to instill the highest standards of integrity in our realigned company. The new management of MCI has made business integrity, open communication, ethics and sound corporate governance the core principles of our company. The changes we have implemented are comprehensive, and they vividly demonstrate our commitment to corporate ethics and integrity. MCI has an entirely new Board of Directors. MCI is actively rebuilding its executive management team, and has installed a new CEO, a new CFO, a new Acting Controller a new Acting Treasurer, a new Executive Vice President of Human Resources, and a new Acting General Counsel. As a result of the work of the Special Investigative Committee of the Board of Directors, a panel on which I served, more than 30 executives have been replaced. Moreover, MCI has rebuilt its finance and accounting operations. In addition to installing a new CFO and Treasurer, more than 400 new financial personnel have been hired. MCI has a new Vice President responsible for instituting sweeping changes in internal controls. The company has also retained an external consulting group to review the adequacy of the company's internal controls implementation efforts. The company's internal audit function now reports directly to the Audit Committee of the company's Board of Directors, rather than to the CFO. The company retained the accounting firm KPMG as its new external auditor in May 2002. Since then, KPMG has conducted an extensive review of the company's financial reporting and internal control procedures, and made recommendations to ensure appropriate accounting practices going forward.

Third, our cooperation in working with the court-appointed Corporate Monitor. The company consented to the appointment of a Corporate Monitor as part of the U.S. Securities and Exchange Commission's investigation of WorldCom securities and accounting issues. That Monitor is Richard C. Breeden, a former Chairman of the SEC. The company has forged a constructive working relationship with the Monitor and his staff, who have virtually unlimited access to company decision-making and information. The Monitor is invited to all Board meetings. The Monitor reviews and approves company compensation and expenditure matters, and is in the process of developing a comprehensive corporate governance report and recommendation. MCI has made a firm commitment to implement the Monitor's recommendations.

To ensure that integrity and business ethics will be at the center of all our activities, MCI has strengthened its ethics procedures, has appointed a new Chief Ethics Officer, and has published a new company-wide Code of Ethics and Conduct. Our top 80 executives have signed a binding ethics pledge, and the compensation of our CEO is directly dependent upon ethical performance. We have implemented a "zero tolerance" policy that dictates that any suspected violation of law, company policy, or the Code of Ethics and Business Conduct will be investigated and will be addressed appropriately. MCI recently conducted a two-day ethics and financial-controls training session for its top executives, and the company is in the process of developing and implementing a company-wide ethics training program.

Fourth, our commitment to transparency and openness. The company recognizes that the small group of former personnel who perpetrated the fraud was able to do so by limiting access to information and evading appropriate internal checks and balances. We have addressed and eliminated the risk that such a circumstance will ever happen again: We have made open, far-reaching communication a hallmark of the new MCI. On a quarterly basis, we conduct a thorough business review of all the company's financial data, business plans and key issues and opportunities with the company's top 80 executives. We have made extensive efforts to

communicate openly and often to employees on all-important company matters, and we have fostered a company culture that encourages communication, questions and discussion among our employees.

Fifth, our settlement with the U.S. Securities and Exchange Commission - and what it says (and what the federal Courts say) about MCI's commitment to business integrity and ethical conduct. The approval, on July 7, of MCI's recent settlement of the SEC's accounting and securities-fraud complaint was a turning point for the new MCI. The United States District Court's approval of the settlement fully supports the conclusion that MCI has implemented, and is committed to sustaining, a corporate culture based on trust and integrity.

One of the most notable aspects of the settlement is that, using the provisions of Sarbanes-Oxley, \$500 million in cash plus \$250 million in stock of the new company will be distributed to shareholders and bondholders defrauded by WorldCom. In a very real sense, the victims of WorldCom's fraud now have a stake in the future success of MCI.

The decision - by Judge Jed Rakoff of the United States District Court for the Southern District of New York - included several very powerful findings that support MCI's position. In his decision, Judge Rakoff wrote: "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. . . . The Court is satisfied that the steps already taken have gone a very long way toward making the company a good corporate citizen." The Court added that the SEC, "with the full cooperation of the company's new management and significant encouragement from the Court-appointed Corporate Monitor, has 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 and obtain some modest, if inadequate, recompense for those shareholder victims who would otherwise recover nothing whatever from the company itself."

The Court's treatment of the same arguments put forward here today by Verizon is instructive and worth noting. The Court said that the argument by competitors, "notably Verizon and AT&T," that MCI should be liquidated, "has not commended itself to the [SEC] and does not persuade this Court. Corporate reorganization under Chapter 11 of the bankruptcy laws always confers a competitive advantage to the debtor in terms of elimination of debt; yet companies rarely seek bankruptcy except as a last resort, for it involves numerous competitive disadvantages as well. . . ."

The Court continued: "...[A]ny suggestions that companies as large and well-positioned as Verizon and AT&T will not be able to compete effectively with the new WorldCom/MCI lacks credence. Verizon, indeed, already enjoys a special competitive advantage of its own by virtue of its status under FCC rules as a de facto local monopoly."

The Court's decision is a ringing endorsement of MCI's actions and commitment. It recognizes that MCI is not - as some of our rivals contend - a company somehow built on or created by fraud. MCI has been built by employees who are driven by a competitive, pioneering spirit, and who seek to deliver the benefits of open market competition: lower prices, technologically advanced products and services, innovation, and an unwavering commitment to customer service.

The Court's decision, moreover, underscores the fact that MCI has long been at the forefront of competition in the telecommunications marketplace. Our company helped break open the long-

distance monopoly that had existed well into the 1970s. We have consistently provided our customers with a greater range of choices, naturally leading to lower prices, better service and product innovation. MCI created a host of new consumer long-distance services, built the first data network, and drove Internet and e-mail innovation.

Given MCI's record of innovation, it's no wonder that our rivals are putting intense pressure on Congress, the General Services Administration and other government decision-makers in an effort to challenge our right to continue to serve the government as a federal contractor. Our rivals' self-serving attacks should have no place in the determination of whether MCI is now indeed a responsible government contractor. In the Court's recent decision, Judge Rakoff saw through the hyperbole of our rivals: "To kill the company . . . would unfairly penalize its 50,000 innocent employees, remove a major competitor from a market that involves significant barriers to entry, and set at naught the company's extraordinary efforts to become a model corporate citizen."

MCI remains a responsible federal contractor under any reasonable interpretation of the applicable standards. Companies that (like MCI) fall victim to misconduct by some executives, but who take meaningful steps to address it, should not automatically be disqualified from competition for government business. We remain able to provide our government customers with the positive benefits of competition, including more choices and lower prices. That surely benefits the taxpayers. It also helps ensure that our satisfied government customers do not face an unwarranted disruption of services.

MCI takes great pride in our many years of service to our federal, state and local government customers. We provide services to nearly every federal government agency, and operate some of the most complex, sophisticated and reliable network solutions ever deployed. Our performance as a government contractor continues to meet and exceed the most exacting standards. Our network is unmatched in scope and capability. We are especially proud of our role in supporting our national-security agencies' infrastructure, and we are gratified by the many positive comments about our service from officials at the U.S. Department of Defense and other national-security agencies. We provide a host of critical network solutions to the federal government, and believe we have demonstrated - and continue to demonstrate - a record that is unparalleled in its rapid response, flexibility and dedication in supporting national-security initiatives, both at home and abroad.

Mr. Chairman, MCI remains an innovative, responsible, cost-effective competitor in the open marketplace. Having fallen victim to a corporate fraud - perpetrated by a relative handful of senior executives, all of whom have now been dismissed - MCI has taken vigorous action to restore the integrity of its procedures and its internal standards. MCI is determined to live up to a high standard of ethical conduct that will set a positive example for all other corporations to follow. MCI is reborn, realigned and ready for competition. It is deeply regrettable that our business rivals, promoting their own business goals, would seek to restrict choice, stifle innovation and limit competition by attacking MCI - and thus would attempt to deny the nation's consumers, and our government, of the proven services MCI provides.

Mr. Chairman, thank you for the opportunity to offer this testimony to you today. I look forward to answering any questions that you and your colleagues may have, and to providing any further information that the Committee may desire.

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