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The WorldCom Settlement and Director Liability

Directors are asking themselves an important question this week in the aftermath of the recently announced WorldCom settlement: Is it still safe to sit on the Board of a public U.S. company in the aftermath of Enron, Sarbanes-Oxley and now the WorldCom directors' \$18 million personal out-of-pocket settlement payments?

Our answer is "yes".

In support of this answer we offer the following observations:

- WorldCom represents an extreme case. It was the largest American company to ever file bankruptcy, with significant allegations of accounting fraud.
- The payments by the directors are part of a negotiated settlement. This is not a judicial decision that sets a new legal standard governing director duties.
- The payment of \$18 million, while significant (purportedly roughly 20% of the directors combined net worth, excluding primary residences, retirement accounts and certain joint marital assets), pales in comparison to the personal financial costs suffered by the outside directors (as well as shareholders and employees) from the loss of value in their WorldCom shares.
- WorldCom is a very high profile case, on par with the likes of Penn Central and Lincoln Savings, and numerous other parties (including the banks) have or will contribute several billion dollars in aggregate to the settlement.
- Scathing reports by Special Investigative Counsel and Bankruptcy Monitor Richard Breeden painted a highly negative picture of the WorldCom directors (with significant focus on the Board's role in approving \$400 million in loans to Bernard Ebbers).

Still, there remain some good reasons for concern:

- In the current environment, there is a huge and growing demand on the part of regulators, enforcement agencies and the public for "personal accountability" on the part of all corporate actors.
- Stephen Cutler, Director of the SEC's Division of Enforcement warned in a September 2004 speech that "Over the next year, we intend to continue focusing closely in our investigations on whether outside directors have lived up to their roles as guardians of the shareholders they serve."
- While the Commission recently rejected a settlement in Global Crossing (involving the non-executive chairman) and a provision of a recent Disney settlement (involving the CEO and then Chairman), due to their expansive notions of director and CEO duties, two Commissioners and the Staff were supportive of the settlements.
- We are witnessing an unfortunate trend in enforcement and private litigation, where each case (no matter what the specific facts of that case), tends to create a new precedent for the next action. There needs to be a strong effort to resist this trend.

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- Few spokespeople today are standing up for the need for balance in the actions taken in response to the Enron and WorldCom scandals and the aggressive enforcement calendar being pursued by the State A.G.s, the SEC and the DOJ.
- Thus, there remains a serious risk that the strong foundations of the business judgment rule and the traditional deference shown to corporate managers and outside directors are being slowly eroded. Some of the post-Enron, post-Sarbanes-Oxley expectations being placed on senior managers and outside directors, are both unrealistic and unfair.

What's a Board to do? We continue to offer the following core advice to all Boards and individual directors:

- If you serve on a board you must be active and attentive. You must put in the time and put in the effort (including by reading all Board materials carefully).
- You must have best-in-class governance practices. The New York Stock Exchange Governance Rules and related best-in-class charters and governance policies that have been adopted by most leading corporations provide a good solid roadmap for what is reasonable to be expected from a board and its committees.
- You must be exceedingly careful in the review of any transactions involving management participation.
- You must take the independence requirements set forth under the Stock Exchange Rules and Sarbanes-Oxley seriously, and avoid any appearance of impropriety. You must act solely in the interests of the company and its shareholders.
- You must do your diligence carefully before accepting a Board seat and associate yourself only with institutions and management teams of high integrity.
- You must take all regulatory/compliance and accounting deficiencies seriously and demand rapid corrective actions on the part of management.
- You should make sure there is adequate D&O insurance including, where practicable, separate "Side-A" insurance covering the directors separate and apart from the corporation. This is particularly important in the context of a bankruptcy.

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