

**UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

<b>SECURITIES AND EXCHANGE COMMISSION, 450 Fifth Street, N.W. Washington, D.C. 20539</b>	)	
	)	
	)	
<b>Plaintiff,</b>	)	
	)	
<b>v.</b>	)	<b>Civil Action No.</b>
	)	
<b>WORLDCOM, INC.,</b>	)	<b>COMPLAINT</b>
	)	<b>(Securities Fraud)</b>
<b>Defendant.</b>	)	
	)	

The Securities and Exchange Commission (“the Commission”) alleges for its Complaint as follows:

1. From at least the first quarter of 2001 through the first quarter of 2002, defendant WorldCom Inc. (“WorldCom”) defrauded investors. In a scheme directed and approved by its senior management, WorldCom disguised its true operating performance by using undisclosed and improper accounting that materially overstated its income before income taxes and minority interests by approximately \$3.055 billion in 2001 and \$797 million during the first quarter of 2002.
  
2. By improperly transferring certain costs to its capital accounts, WorldCom falsely portrayed itself as a profitable business during 2001 and the first quarter of 2002. WorldCom’s transfer of its costs to its capital accounts violated the established standards of generally accepted accounting principles (“GAAP”). WorldCom’s improper transfer of certain costs to its capital accounts

was not disclosed to investors in a timely fashion, and misled investors about WorldCom's reported earnings. This improper accounting action was intended to manipulate WorldCom's earnings in the year ending 2001 and in the first quarter of 2002 to keep them in line with estimates by Wall Street analysts.

3. By engaging in this conduct, WorldCom violated the anti-fraud and reporting provisions of the federal securities laws and, unless restrained and enjoined by this Court, will continue to do so. The Commission requests, among other things, that Worldcom be enjoined from further violations of the federal securities laws as alleged herein, and that it pay a monetary penalty.

### **THE FRAUDULENT SCHEME**

4. WorldCom is a major global communications provider, operating in more than 65 countries. WorldCom provides data transmission and Internet services for businesses, and, through its MCI unit, provides telecommunications services for businesses and consumers. WorldCom became an important player in the telecommunications industry in the 1990s. However, as the economy cooled in 2001, WorldCom's earnings and profits similarly declined, making it difficult to keep WorldCom's earnings in line with expectations by industry analysts.

5. Starting at least in 2001, WorldCom engaged in an improper accounting scheme intended to manipulate its earnings to keep them in line with Wall Street's expectations, and to support WorldCom's stock price. One of WorldCom's major operating expenses was its so-called "line costs." In general, "line costs" represent fees WorldCom paid to third party telecommunication

network providers for the right to access the third parties' networks. Under GAAP, these fees must be expensed and may not be capitalized. Nevertheless, beginning at least as early as the first quarter of 2001, WorldCom's senior management improperly directed the transfer of line costs to WorldCom's capital accounts in amounts sufficient to keep WorldCom's earnings in line with the analysts' consensus on WorldCom's earnings. Thus, in this manner, WorldCom materially understated its expenses, and materially overstated its earnings, thereby defrauding investors.

6. As a result of this improper accounting scheme, WorldCom materially underreported its expenses and materially overstated its earnings in its filings with the Commission, specifically, on its Form 10-K for the fiscal year ending on December 31, 2001, and on its Form 10-Q for the quarter ending on March 31, 2002.

7. In particular, WorldCom reported on its Consolidated Statement of Operations contained in its 2001 Form 10-K that its line costs for 2001 totaled \$14.739 billion, and that its earnings before income taxes and minority interests totaled \$2.393 billion, whereas, in truth and in fact, WorldCom's line costs for that period totaled approximately \$17.794 billion, and it suffered a **loss** of approximately \$662 million.

8. Further, WorldCom reported on its Consolidated Statement of Operations contained in its Form 10-Q for the first quarter of 2002 that its line costs for that quarter totaled \$3.479 billion, and that its income before income taxes and minority interests totaled \$240 million, whereas, in truth and in fact,

WorldCom's line costs for that period totaled approximately \$4.276 billion and it suffered a **loss** of approximately \$557 million.

9. Worldcom's disclosures in its 2001 Form 10-K and in its Form 10-Q for the first quarter of 2002 failed to include material facts necessary to make the statements made in light of the circumstances in which they were made not misleading. In particular, these filings failed to disclose the company's accounting treatment of its line costs, that such treatment had changed from prior periods, and that the company's line costs were actually increasing substantially as a percentage of its revenues.

### **JURISDICTION**

10. The Commission brings this action pursuant to Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d)].

11. This Court has jurisdiction over this action pursuant to Sections 21(d), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d) and 78aa].

12. The defendant, directly and indirectly, has engaged in, and unless restrained and enjoined by this Court will continue to engage in, transactions, acts, practices, and courses of business that violate Sections 10(b) and 13(a) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78m(a)] and Rules 10b-5, 12b-20, 13a-1, and 13a-13 thereunder [17 C.F.R. §§240.10b-5, 240.12b-20, 240.13a-1, and 240.13a-13].

### **THE DEFENDANT**

13. WorldCom is a Clinton, Mississippi-based company incorporated in Georgia, which provides a broad range of communications services to both U.S.

and non-U.S. based businesses and consumers. WorldCom is a public company whose securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act and it is required to file periodic reports with the Commission pursuant to Section 13 of the Act. Throughout the relevant time period, WorldCom's stock was covered by Wall Street analysts who routinely issued quarterly and annual earnings estimates.

## **CLAIMS FOR RELIEF**

### **FIRST CLAIM**

14. Paragraphs 1 through 13 above are incorporated herein by this reference.

15. Defendant Worldcom, directly or indirectly, by use of the means or instruments of interstate commerce, or of the mails, or of a facility of a national securities exchange, knowingly or recklessly (a) employed devices, schemes and artifices to defraud; (b) made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaged in acts, transactions, practices, and courses of business which operated or would operate as a fraud or deceit upon the purchasers of securities and upon other persons, in connection with the purchase or sale of a security.

16. Defendant WorldCom, and members of its senior management, knew, should have known, or were reckless in not knowing, that its 2001 Form 10-K, and its Form 10-Q for the first quarter of 2002, including the financial statements contained therein, as filed with the Commission, contained material misstatements and omissions.

17. By reason of the foregoing, WorldCom violated Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5.

## **SECOND CLAIM**

### **Violation of Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1, 13a-13, and 12b-20**

18. Paragraphs 1 through 13 are hereby realleged and incorporated herein by reference as if set forth fully.

19. Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers of registered securities to file with the Commission factually accurate annual and quarterly reports. Exchange Act Rule 12b-20 provides that in addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made. not misleading.

As a result of the accounting actions set forth above, WorldCom violated Section 13(a) of the Exchange Act and Exchange Act Rule 13a-1, 13a-13, and 12b-20.

## **PRAYER FOR RELIEF**

WHEREFORE, the Commission respectfully requests that this Court:

Enter Orders:

A. Permanently restraining and enjoining WorldCom from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

B. Permanently restraining and enjoining WorldCom from violating Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder;

C. Imposing civil monetary penalties on WorldCom pursuant to Section 21(d) of the Exchange Act [15 U.S.C. § 78u];

D. Prohibiting WorldCom and its affiliates, officers, directors, employees, and agents, from destroying, altering, or removing from the court's jurisdiction any documents relevant to the matters alleged herein;

E. Prohibiting WorldCom and its affiliates from making any extraordinary payments to any present or former affiliate, or officer, director, or employee of WorldCom, or its affiliates, including but not limited to any severance payments, bonus payments, or indemnification payments.

F. Appointing a corporate monitor to ensure compliance with items D and E, above; and

G. Granting such other and additional relief as this Court may deem just and proper.

Respectfully submitted,

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