GLOBAL CROSSING: THE PHOENIX RECOVERED FROM ENRONITIS. LESSONS FROM THE BIGGEST NETWORK ON EARTH. CASE ANALYSYS FROM THE CORPORATE GOVERNANCE PERSPECTIVE. ♦

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Introduction

Global Crossing is a company established in the United States. It was and still is a giant in the world of telecommunications. The company suffered a crisis in the early two thousands in having to face USA bankruptcy protection law (Chapter 11). However, Global Crossing is now one of the most powerful multinationals in the sector and recently conquered the Latin American market by acquiring IMPSAT, which was the largest telecommunications company in America (North, Central and South America)[2]. This means that Global Crossing is the owner of the largest network in the globe with subsidiaries registered in twenty six countries[3], and fifty locations all over the world[4]. Global Crossing provides a wide range of services which include the value added services, the telecommunication services and information security.

In the digital era, communication services have become essential and the fall of a massive company such as Global Crossing can destabilize the market, the systems and increase the prices of telecommunication services. Therefore, the lessons learnt from the bankruptcy debacle are indispensable for avoiding a second fall not only in Global Crossing, but in other telecommunication companies that might have been

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2 CARDENAS A. "Global Crossing adquiere a IMPSAT por $336 millones." (Global Crossing Acquires IMPSAT for $336 millions). Optical IP news. Peru, October the 26th 2006 http://www.opticalip.com.pe/newsblog/?p=31

3 Global Crossing web Site: http://www.globalcrossing.co.uk/company/company_locations.aspx

4 Supra Note 2.

using the same spurious practices which led Global Crossing to the crisis investigated in this study.

This essay aims firstly to recall and analyze the Corporate Governance failures that led to the crisis and some of the most remarkable mistakes. Secondly, it intends to produce an in depth analysis of the governance policies that were produced after the crisis to conclude if they will be effective in preventing future financial catastrophes.

Global Crossing certainly happened to have most of the failures in governance that it is possible to conceive of, and the most significant of these will be addressed deeply. The others will only be mentioned in terms of the most up-to-date legal debates regarding how to effectively prevent governance failures.

Before continuing ahead with the facts and analysis of the case, it is important to review the concept of corporate governance and its fundamental principles. This will provide a better understanding of the issues raised in the case and will also encourage the reader to have a critical view of the ideas proposed in this text.

a. Corporate Governance, what it is, what it should be, what it has to be done.

The concept of corporate governance is not an homogeneus idea amongst the doctrine, mainly because of the structural differences in the companies themselves. It is also not a neutral academic creation in that Corporate Governance has a clear objective which is to prevent the agency problem (i.e., provide protection to certain participants of the business activity[5] from the potential abuses of others), and thus the concepts vary according to the position of the person providing the definition.

There is, however a common notion that underlies in all the different definitions, which is that certain specific governance practices are necessary (although not sufficient) to avoid undetected corporate catastrophes.

In its very origins, the concept of Corporate Governance had three objectives:

The first one was to protect the shareholders against the abuses of the directors and managers. Secondly, to bound the decisions of the company to the interest of the shareholders. And thirdly, to clarify that in all cases of conflicts of interest, the shareholders interests should prevail[6]. This is under the idea that shareholders are the providers of funds suppliers in the company and need a way of protecting their investment[7].

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[5] BAQUERO, Mauricio. "El gobierno societario y de la empresa en Colombia. Una herramienta (Contractual) o un requisito (normativo)". XXIII Congreso de Derecho Comercial. Cámara de Comercio de Medellín para Antioquia, Colegio de Abogados de Medellín y Universidad Externado de Colombia. Medellin, Octubre de 2006. P. 1.

[6] Supra N. 4 P. 2

[7] SHELIFER AND VISHNY. "A Survey of Corporate Governance" The journal of finance. Vol 52 No. 2 1997 p. 737

That concept has evolved according to different political systems, and also with the changing of the companies themselves. Also it has been transformed by the influence of companies in society and the social impact of the corporate failures.

When big crises have risen in the corporate world, it has been clear that despite being the most affected, shareholders are not the only ones in need for protection. This has given space for the concept of stakeholders[8] and the extension of the main objectives of corporate governance to them. Also, the increasing awareness of the huge power held (and sometimes abused, by companies), has been the key to open the door to other concepts such as corporate social responsibility.

Stakeholders' interests are not always the same as the ones of shareholders as the main interest of shareholders is to create profits from the company. Instead, and depending on the specific stakeholder, these interest can vary in several ways and can even be in conflict with the shareholders main objective[9].

This has also transformed the concept of Corporate Governance, at least in its objectives. Currently, even though there is still not a clear and universal definition, it can be stated that Corporate Governance is a set of practice intended to obtain the following objectives:

-Strategic Focus

- Predictability

- Transparency

- Participation

- Accountability

- Efficiency & Effectiveness

- Stakeholder Satisfaction[10]

b. Fundamental Principles.

There are two important papers to which we must make reference to in examining the Fundamental Principles. In 2004, the OECD published a paper of "Revised Principles" which aimed to 'help develop a culture of values for professional and ethical behaviour on which well functioning markets depend'[11]. Following from this the White Paper on Corporate Governance in Latin America was developed to deal with specific charactaristics of the region. Examples of such issues include the influencial role of certain large companies in the development of the industry (eg Global Crossing), and an increased amount of family owned businesses in the region compared to other

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[8] Stakeholders are the people who has an interest on the company but do not hold shares i.e. workers, surrounding community, the environment protector, creditors and consumers

[9] PEREZ C. Elena. *Corporate Governance: Shareholders Interests and other Stakeholders interests*. Corporate ownership & Control. V. 4 Issue 4, Virtus Interpress. Summer 2007 P. 6.

[10] *Financial Aspects of Corporate Governance*. (The Cadbury Report). The Committee on the Financial Aspects of Corporate Governance and Gee. 1992.

[11] *OECD Principles of Corporate Governance*. Organisation for Economic Co-operation and Development 2004.

comparable areas. These (and other) factors heighten the need for effective corporate governance to ensure transparency and protect both shareholders and stakeholders in general.

The Revised Principles of Corporate Governance have been compiled into a non binding set of principles by the OECD, which takes into account the objectives of corporate governance. Due to their non-binding nature, there is no regional requirement to enforce the principles. However they do provide a solid base for goverments and companies to either use as their own or expand upon within their particular circumstances. They also serve as a reference point when the debate on corporate governance arises.

It is important to mention that the Revised Principles were published in 2004 as a response to the past corporate crises of major companies around the world, and they contain deep analyses on the actions that should be taken in order to prevent future corporate failure.

The OECD Principles are summarised into six main groupings. These are:

1) Ensuring the Basis for an Effective Corporate Governance Framework.
2) The Rights of Shareholders and Key Ownership Functions.
3) The Equitable Treatment of Shareholders.
4) The Role of Stakeholders in Corporate Governance.
5) Disclosure and Transparency.
6) The Responsibilities of the Board.

The White Paper is also a non-binding document developed through four rounds of meetings by 8 Latin American countries and various other stakeholders[12]. The paper assesses the importance of good corporate governance, addresses the regional characteristics[13] and reform priorities and then provides a framework of constructive recommendations.

Possibly the most important aspects of the paper are the priorities identified as these are the principles to which the recommendations aim to rectify and would also be the basis of any separate governance codes which may be developed by a country or entity without reference to the recommendations provided.

The priorities are listed as follows:

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[12] Stakeholders included the OECD, the USA, Spain, UK, World Bank, IMF and various other international organisations.

[13] Specific regional characteristics mentioned include Privatisation, Concentration of Ownership, Defined Control and the Need for Capital, Importance of Industrial Groups, Restructuring of Banking Systems, Regionalisation, Internationalisation, and the Importance of Multinational Enterprises, Limited Domestic Capital Markets and Growing Importance of Foreign Listings, Mandatory Privately-Managed Pension Schemes and Legal Traditions and Enforcement Patterns.

1) Taking Voting Rights Seriously.

2) Treating Shareholders Fairly during Changes in Corporate Control and De-listings.

3) Ensuring the Integrity of Financial Reporting and Improving the Disclosure of Related Party Transactions.

4) Developing Effective Boards of Directors.

5) Improving the Quality, Effectiveness and Predictability of the Legal and Regulatory Framework.

6) Continuing Regional Co-operation.

These priorities are then to be implemented using the given recommendations. Whilst extensive guidance is given on each item of the recommendations with various subheadings, they can be summarised into the following broad categories:

1) The Rights of Shareholders.

2) The Equitable Treatment of Shareholders.

3) The Role of Stakeholders in Corporate Governance.

4) Disclosure and Transparency.

5) The Responsibilities of the Board.

6) Improving Compliance and Effective Enforcement.

7) Regional Co-operation.

1. The Facts

To provide an in depth analysis of the legal situation in Global Crossing's case and, more specifically of the corporate governance failures, it is necessary to briefly review the facts that converted a wealthy company into a prey for a cheap acquisition which proved very profitable after a short time.

Because this is intended to be a legal overview of the Corporate Governance situation, the numbers will be omitted in order to make the text more understandable and as simple as possible. However, it is important to recall that the numbers that powered the administration changes are the consequence of the Governance failures that will be mentioned during the development of the study.

Global Crossing was established in 1997 by Gary Winnick and three business associates through Pacific Capital Group[14]. From 1997 until 2002, Winnick held the title of chairman; Lodwrick Cook, was hired 1998 as co-chairman[15]. John Scanlon became Global Crossing's first CEO in 1998. In February of 1999, he was replaced by Robert

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[14] "Pacific Capital Group, Inc. ("PCG") was founded in 1985 by Gary Winnick and has been a leading principal equity investor and merchant banking firm. PCG provides capital to global companies in the telecommunications, technology, internet, media, real estate and healthcare sectors. PCG was the founder of Global Crossing, Ltd." http://www.vclocator.com/Venture-Capital/01152/Pacific-Capital-Group-Inc..html

[15] "The Rise and Fall of Global Dreams," New York Times, March 3, 2002

Annunziata, who resigned his position as president of AT&T's business services group to become Global Crossing's CEO. AT&T was a competitor of Global Crossing, but at the time, it was much bigger and more powerful than the new company. Annunziata pushed the overwhelming growth of the company by making ambitious acquisitions of other companies and large investments in infrastructure[16]. In the year of 1999, "*The final major play the company underwent this year was a three way venture between Microsoft, Softbank, and Global Crossing to create Global Crossing Asia. This company would allow for the Asian market to rapidly gain access to new and better telecom services"*[17]. Despite the growth of the company, in March 2000 Annunziata resigned.

After Annunziata's resignation, Leo Hindery was put in charge of the company. During Hindery's short administration (seven months) Global Crossing saw its highest peak in the stock price. The constant changes of CEO are thought to be due to apparent conflicts between the company's chairman Gary Winnick and the directors.

During Hindery's administration some hints of the crisis to come appeared. The company started attempting to obtain funding from stock offerings and selling assets. However, projections suggested the company would have a positive cash flow by early 2002. Those projections never materialised.

After Hindery left the company in 2000 (also because of conflicts with Winnick) the place of CEO was taken by Thomas Casey. Under Casey's administration the company consolidated its main networks. These networks allowed them to expand their business globally. Nonetheless, the company was not fundamentally sound and despite the expansion the stock plummeted and in November 2001 the company entered into Chapter 11. Some of the company's assets (particularly in Global Crossing's Asian operations) were finally sold to Asia Netcom.

John Legere took the position of CEO of the company in October 2001. He managed the crisis, helped the company emerge from Chapter 11, and still occupies the position of CEO. Global Crossing's bankruptcy is considered one of the biggest ten in the United States of America.

2. What went wrong?

In Global Crossing's case the causes of the crisis were multiple. Some of them were related to corporate governance, but the truth is that the whole sector of telecommunications was going through difficulties because "*of the changes in technology and decrease in the economy"*[18]. The changes of technology obliged the companies to adjust quickly, and this led to financial trouble for those who could not cope with such adjustments.

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[16] During Annunziata's period, Global crossing acquired Frontier Corp, and "Global Marine", amongst other companies. The company also grew in number of workers in a rate of more than 50%

[17] NORTON, VANDINE, KERNS. *Case on Global Crossing*. May 29th 2002. P. 2 http://oak.cats.ohiou.edu/~an169700/esp/case.htm

[18] Supra Note 13 P. 3

Additionally, Global Crossing executives "*severely overestimated the demand for their networks."*[19] The worldwide telecommunication crisis lowered the need for broadband, which was one of the company's biggest products. Also, unwise decisions about the position of the undersea cable created a lack of clients for this service.[20] This submarine cable network was one of the largest investments made by Global Crossing, but the investment did not produce the return expected because there were not enough clients (with financial capacity to pay for, at least, the net cost of the services) in the area where it was installed.

Despite these considerations, it can be stated that corporate governance mistakes were significant in escalating the crisis. Even if the lack of experience and excess of ambition harmed the company, the bankruptcy was driven by the spurious practices of the chief executives and the accountancy team as will be noted in the rest of this essay.

2.1. The board

Decisions like taking on billions of US Dollars in debt to build an undersea fiber-optic cable system that now only represents 20% of all undersea capacity leaving the U.S.[21] were overly ambitious and unrealistic about the real financial capacity of the company. The approval of those decisions shows that there was no genuinely independent advisor on the board.

Regarding this case, it is important to stop and consider whether an independent executive would have helped the situation. Within Global Crossing, Gary Winnick had a huge and charismatic power base as a non executive chairman. The ambitions of the company were *his* ambitions, and subsequently, the mistakes in these decisions were *his* mistakes. It is not likely that any board would have had the power to stop the decisions that he had encouraged with such great enthusiasm, even if it did contain experts. Essentially, whilst he may have been non-executive, Gary Winnick was certainly not independent.

On the other hand, it is evident that Global Crossing used poor, if not criminal, accounting practices. Therefore, the manipulations on the balance sheet could easily have been hidden even from members of the board in order to pursue the over ambitious economic goal that the founder of the company had for *his* company.

One of the big contradictions in Global Crossing's case is that the chairman (Gary Winnick) was not found liable (amongst other reasons studied in the following sections) in the bankruptcy case due to not *having enough involvement in the company's day to day operations*[22]*.*This was despite his huge influence on the company's policies.

As can be seen by the number of CEOs that passed through the company in a very short time, even chief executives had to maintain a good relationship with Winnick. Otherwise, the situation would become unbearable, forcing the executives to resign.

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[19] Supra Note 13 P. 4

[20] Supra Note 13 P.5

[21] DENNIS K. BERMAN, PHILLIP DAY and HENNY SENDER. "Global Crossing Files for Chapter 11, Plans to Reorganize With Asia Firms". The Wall Street Journal. January 27 2002

[22] TAUB S. "No Charges for Global Crossing's Winnick". CFO.com. December 14 2004

In conclusion, Global Crossing's board was not powerful enough to contradict Gary Winnick's ideas. In this case, the separation of personalities between the company and its founders was only formal. The chief executives followed the example of their chairman in making the most (for themselves) out of the company. This involved obtaining economic benefits for the company without thinking critically about the ventures in which the company was getting involved. The corporate governance issue in this area was that the board was not independent from the founder; therefore, the members were looking for personal benefits instead of the benefit of the company. This clearly shows how the agency problem of shareholders interests had failed and the directors were no longer acting as stewards of the business on the shareholders' behalves.

Finally, the main error of the board is that they did not perceive that the *management* of the company was poor, even though they had access to the information that the company was not *making* any money in the business of telecommunications. Indeed, they took the decision to get the money needed to operate out of other transactions, both in the stock market and the publicity sector. When a company does not make money in their own operations, cash flows quickly become problematic and eventually (even if none of the other corporate failures are present) the company runs out of the funds necessary to keep operating.

a. The director's remuneration, insider trading, speculation, fraud?

One of the factors that brought instability to Global Crossing was the directors' and executives' remuneration which included loans, stock options and excessive bonuses. More specifically, the insider trading by the executives probably led to an increased volatility of the stock market affecting people's perception of the company, and thus their decisions to buy or sell stock[23].

The directors knew that the company was undergoing a crisis and did nothing about it but make money from it while enhancing fallacious speculations. This was a breach of their duties to avoid conflicts of interest and promote the success of the company. However, it is difficult to establish exactly what fault they are guilty of because there is no single action that constitutes the breach, but repeated practices and several measures that eventually could be justified as business strategies. Also, it is hard to draw the line between a criminal action and a simple breach of duties.

Gary Winnick, the founder and Chairman of the company from its establishment until the filing of Chapter 11, was investigated by the FBI on cases of fraud[24] because of suspicious accounting maneuvers like revenue acceleration[25]. As the leader of Global Crossing, he was the wizard that magically sold more than US $600 millions in Global

[23] Heather Milkiewicz and Shang-Jin Wei. *A Global Crossing for Enronitis?: How Opaque Self-Dealing Damages Financial Markets around the World*. Brookings Review, Vol. 21 Spring 2003
[24] PALAZZO A. "Winnick case has path of obstacles in way of officials.(Global Crossing Ltd. Chairman Gary Winnick)". Los Angeles Business Journal. 21 Oct 2002.
[25] WAYMAN R. "Cooking The Books 101". Investopedia ® "*One way to accelerate revenue is booking lump-sum payment as current sales when services will be provided over a number of years.*" http://www.investopedia.com/articles/analyst/071502.asp

Crossing stock[26]. He was also the person selling his stock and profiting from it when the company was struggling[27].

His attitude was, at least, a breach of the Director's Fiduciary Duties (if not outright fraud). Furthermore, his actions were severely negligent and possibly even malicious. He was the company's non executive chairman, and his attitude was imitated by the rest of the chief executives who obtained benefits from their stock options while the telecommunication crisis was hitting the sector and the company was having trouble finding business.

Selling stock of a company during hard times is not a crime; in fact, the stock options for the executives seem to have had no other purpose than to provide incentives to the executives. However, good practice by the executives (not only in the management of the company but in the use of their stock options) is fundamental to avoid a major crisis. In this case, it would have been better to link such incentives to performance over fixed periods of time, and to maintain them on condition of the continued good financial health of the company.

The undue trading in the stock could have also been avoided with a more transparent system of insider trading. This would have involved publicizing the transactions that the executives made with their stock. Such preventive measures have been successfully applied under the Sarbanes Oxley Act in the United States and also exists in different codes of good corporate practices[28] such as the Combined Code of Principles of Good Governance and Code of Best Practice used in the United Kingdom[29].

2.2. The Creditors

a. The banks

The crisis would not have occurred if creditors had been aware of the crisis to come in the sector. Negligent investment played a significant role in the bankruptcy. Dan Cohrs, Global Crossing's Executive Vice President and Chief Financial Officer, says that *"Global Crossing's vision of a global fiber optic network was endorsed and supported by the equity and debt markets, throwing literally billions of dollars at the company through debt and equity issues"*.[30]

To what extent the creditors were responsible is a question which the doctrine has not answered unanimously. In ideal conditions, investors would have an accurate knowledge of the financial situation of the company on which they could base their

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[26] PALMRI and WEINTRAUB. *As Global Crossing Sinks, Gary Winnick Stays Dry*. Business Week magazine. Oct 22 2001. http://www.businessweek.com/magazine/content/01_43/b3754058.htm

[27] PALAZZO A. *Sincerity of Winnick's $25 million pledge questioned - Up Front - Global Crossing Ltd. case - Brief Article*. Los Angeles Business Journal. 07 Oct 2002.

[28] Such Act and Codes were issued and implemented after the big corporate crisis, and as a result of them.

[29] THE COMBINED CODE PRINCIPLES OF GOOD GOVERNANCE AND CODE OF BEST PRACTICE S. 1 (A5) (B2) (D3).

[30] Bankruptcy Creditors' Service, Inc. GLOBAL CROSSING BANKRUPTCY NEWS, V. 24. First Issue, January 2002. http://bankrupt.com/global.txt

projections and analysis. If this had happened, the investors simply would not have put their money into such a risky business.

However, it is necessary to emphasize that the source of information on which creditors base their analysis is none other than that provided by the company itself. They produce an analysis of the possible consequences of investing based on the company's financial statements. Therefore, it is very difficult to appoint liability to the creditors for wrongfully allocating resources to companies that do not meet the requirements, if their primary source contains manipulation of the financials, and other sorts of "accounting tricks". These will mislead whoever reads them, even if that reader is an expert financial analyst.

In Global Crossing's case, it is true that the banks poured money into a worthless company, and this created the enormous debt that triggered the crisis. However, excessive granting of credit was not a **cause** of the crisis, but rather a **symptom** of it. This means that even if the creditors who put their money into Global Crossing had not done so, the company would have secured alternative sources of money (either by investing or credit) through manipulation in the same manner. However, it must be noted that creditors are required to provide stricter controls in risk management precisely because of the nature of their activity.

2.3 The Investors

The spiral of the lack of income caused from the poor performance in business led the company to take on debts that they were unable to cover with revenues. There were two actions taken by the board that accelerated the fall and resulted in bankruptcy. Firstly, they used poor accountancy practices and secondly, they obtained a level of credit that the company was eventually unable to repay.

The investors' role in this case was not incidental; they had the expertise and the tools available to find out the real situation of the company. Their negligence can be classed as one of the causes of the problem. Nonetheless, it is necessary to remember that in doing business, the presumption of contracting parties is that the other party is an honest trader. Therefore, it does not seem reasonable to demand from investors an exhaustive investigation of the sources of information. It is reasonable to assume that they believed the information provided by the company was correct. However, dishonesty was noticeable by its absence in some of the investments made in Global Crossing, as was the case with pension funds.

a. Indirectly investing: Pension Funds

Pension funds also had investments in another company which at the same time wrongfully invested in Global Crossing and were seriously affected by the crisis. More specifically, "*Ullico, a privately held insurance company which is owned largely by unions and their pension funds, was an early major investor in Global Crossing and its directors used the telecom's volatile stock price history to personally enrich themselves at the expense of the union members and retirees whose pension funds own Ullico*"[31].

[31] Testimony before the Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises of the Committee on Financial Services, U.S. House of Representatives. *Ullico And Global Crossing: The Tip of the Union Pension Fund Scandal Iceberg.* Presented by Kenneth F. Boehm, Chairman. National Legal and Policy Center. May 1st 2002.

The diligence of Ullico's investors is questionable, since Gary Winnick offered them a great deal with the availability of the stock, likely too much not to be somewhat suspicious.[32]

Also, it was proven that Ullico's directors obtained a benefit from the early investment made in the company and *they* also had stock options of Global Crossing which they used to obtain cash flow when their own company was not doing well in business[33]. Ullico's situation seems to have replicated the very situation that led Global Crossing to bankruptcy, but on a smaller scale.

Ullico's directors deliberately exposed the pensions to a high risk by supporting an investment that was bad for the fund under an undercover agreement[34] from which they obtained personal benefits. This can have many legal definitions, like breach of the duty of avoiding conflicts of interest and fraud, but to put it simply it was corruption. The manner in which the investment (and therefore, the debt of Global Crossing that eventually lead to bankruptcy) could have been avoided was simply by acting honestly. There is no legal formula for that, *sunshine is the best disinfectant*[35]*.* It should be noted that Ullico's high executives were investigated and found liable for their breach of duties.[36]

2.4 The Gatekeepers

Global Crossing's accountants and auditors were not only aware of the problem, but also added to it. They neglected to alert the board or the authorities to the bad consequences that the Company was going to suffer as a result of the speculations and manipulations that they were also contributing to.

Firstly, acknowledging that the company was not receiving money from its operations, the internal accountants started practising revenue acceleration[37]. This was either noticed by the auditors, (in which case they surprisingly did not think that it was a reason to blow the whistle, as they did not take any action to prevent it), or it went unnoticed which is even more dramatic, as it shows their ineptitude for performing the task for which they were hired.

The auditor (Arthur Andersen) has also been involved in other company collapses (WorldCom, Enron)[38]. Whilst it is true that they were not found guilty of fraud in any of

[32] Notice the double corporate governance failure: 1. pension funds did not track the investments made by the companies they owned, 2. Managers of the second company were effectively bribed by GC directors in a perfect combination leading to great losses for the Pension Funds.

[33] Supra, note 26

[34] Supra Note 23

[35] Supra, Note 26.

[36] Supra Note 23

[37] One of the most common forms of revenue acceleration is to include in the balance sheets as revenues for the term accounted, the revenues expected from signed contracts from which the payments have not been received yet. Therefore, the revenue is nonexistent, it is just a future expectation secured only by an agreement.

[38] Precisely, Arthur Andersen went out of business because of these collapses that made it lose all credibility amongst clients and thus the company was dissolved.

these bankruptcies it remains at least suspicious that they could have been so blind to the irregularities in the accountancy that led these companies to file for Chapter 11[39].

In Global Crossing's case, the gatekeepers' failure was not the only cause of the problems because the company was not making generating cash anyway. Nonetheless, they could have prevented the company from getting into so much debt, which could have possibly avoided bankruptcy. Currently, the new regulations under the Sarbannes Oxley Act forbid revenue acceleration in the financials, thus ensuring that they are more realistic and once again encouraging transparency in companies' transactions.

3. Personal Liability, Criminal Liability?

Directors of companies have specific duties that have been slowly decanted and codified around the world. This has happened not only in the USA but also in in Europe, and more precisely in the UK - the world's financial center and where they were recently compiled in a code[40]. These duties arise because of the trust put in their preparation and experience in the business developed by the company. Breaching these duties can lead to personal liability of the directors. However, it is very hard to prove breaches of duty. For instance, it is extremely difficult to draw the line between an audacious business risk and a breach of the duty of skill and care.

In Global Crossing's case, the directors breached their duties (evidently, the duty of skill and care, and subject to proof, the duty of avoiding conflict of interest and promoting the success of the company). Hence a personal liability on the bankruptcy should have been imposed on them personally. *The best way for executives to prevent themselves from ever being personally liable for corporate governance issues is simple (at least in theory). Directors that put in the time, pay attention, focus on the real issues and act in what they honestly believe to be in the best interest of the company and its shareholders as opposed to their own personal interest are very unlikely to be held personally liable for any decision*[41]**.**

The liability of Gary Winnick was also questioned as his actions were investigated by the criminal authorities of the United States. He was found not guilty because the Securities and Exchange Commission[42] (SEC) could not find enough proof of fraud or insider trading[43], but the SEC made some interesting findings.

Firstly, they found that "*executives failed to provide regulators with adequate disclosure about certain, critical swap transactions*[44]". Secondly, the SEC established that *"the*

[39] COFEEE J. *Gatekeepers. The professions and corporate governance*. OUP 2006 page 47.
[40] UK Companies Act 2006 sections 170- 177.
[41] CASPERIE J. *Inside the Minds: Corporate Governance Law*. WILSON SONSINI GOODRICH & ROSATI Professional Corporation. Aspatore Books. USA. P. 6.
[42] The Securities and Exchange Commission is an agency pertaining to the FBI intended to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. http://www.sec.gov/about/whatwedo.shtml
[43] TAUB S. *No Charges for Global Crossing's Winnick*. CFO.com. December 14 2004.
[44] Supra Note 38.

accounting for the transactions was wrong but wasn't done with intent to commit fraud[45]."

4. The Law, The policy

As a result of bankruptcies due to corporate governance failures, the Sarbanes Oxley Act was issued in October 2002 by the United States. This intended to protect national investment in foreign countries, improve transparency in companies' governance and prevent new debacles such as the ones experienced by some of the biggest companies of the USA including Enron, WorldCom and, of course, Global Crossing.

Perhaps as a result of the paranoia generated by the multiple crises, the new regulations in Sarbanes Oxley Act were excessively broad. To mention only two of the most remarkable and excessive novelties, under the new regulations the CEO´s of foreign companies operating within the United States (and companies established outside the USA but with a major investment of American sources) were forced under the law "*to accept personal criminal liability for the validity of their companies' financial statements*[46]". Also the act made lawyers enter formally and with specific obligations into the gatekeepers' category. Under these new provisions, lawyers face a dilemma between their professional duty to their clients and the new legal obligation of withdrawing from representing a corporate client if they detect fraud and the company doesn't provide any remedies after *the lawyer brings it to the attention of high-level officers*[47].

The Sarbanes-Oxley Act was both a token of the megalomania of the congress of the United States and a very strict reaction to a problem. Therefore, it might scare away valuable investment from the United States, which indeed occurred, also caused by other measures such as the Money Laundering regulations. However, it is a stringent position intended to enhance the transparency of the companies and has shown tangible results including the publicity of a company's transactions, main investors, internal shareholders and their transactions.

Conclusions

It is relatively easy to spot the mistakes of a company **after** it has collapsed, but remains very hard to see them **while** the company is collapsing, and even more so, to foresee them when everything is apparently well. Fortunately for Global Crossing, the issues that led to Chapter 11 can be a tool to prevent such dangers in the future of the company because of these lessons of the past. There is no magic formula for avoiding financial problems, but at least good corporate governance practice can diminish their impact and prevent them from destroying the company.

Global Crossing has been recovering rapidly from the crisis. They have already invested in substantial infrastructure and have started with a company free from debt. The new opportunity given to this company is an exceptionally good chance to apply the lessons learnt from the previous crisis.

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[45] Supra Note 38.
[46] RHODE ISLAND SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS. *Sarbanes-Oxley Act aims to fix old problems poses new ones*. What Counts journal. Winter 2002 Vol. 1. No. 1
[47] Supra Note 38

Currently, Global Crossing has a transparency policy intended to both meet the requirements of the Sarbanes Oxley Act and to regain the confidence of clients and investors. This is going to be important in the future for preventing economic-difficulties and from periods of recession causing liquidity problems or a large scale crisis as happened in the past.

New acquisitions, ventures and investments must all be done with transparency, whilst taking fewer risks to ensure sound growth of the company (even if it is slower). Accounting practices need to be kept as strict as possible to avoid "inflated" balance sheets and reduce volatility of the stock market.

Briefly, it can be said that Global Crossing incurred in the following governance failures:

- Lack of independence of managers and board of directors from founders and stockholders.
- Irresponsible investment: Ullico's case.
- Lack of transparency: insider trading.
- Director's remuneration not bound to performance and breach of duties.
- Insider trading in detriment of the company's interest.
- Investors' negligence: suspicious investment.
- Banks irresponsible lending: excessive debt acquired underestimating real payment capacity.
- Speculation.

In summary, the strategies that must be put in place to avoid a future collapse (and that would have prevented the commented bankruptcy from happening) are:

1. Transparency in Insider trade: because of the fact that high executives have *the most up to date information on their company's prospects*[48]*,* transparency in the transactions they do with their stock is very important regarding early detection of a possible crisis*. Heavy selling by one or both groups can be a sign of trouble ahead*[49]*,* despite recommendations in other directions made by the analyst firms.

2. In House lawyers: Transparency in contracts and legal documents is essential for tracking down authors of corporate mistakes and uncovering fraud when it occurs, although stock movements are not subject of revision from the in house lawyers, other important documents that might be a sign of unsound governance can be easily spotted by them. To prevent a crisis, the job of the in house lawyers is crucial because they revise the terms of all contracts signed by the company and have access to the board's deliberations through the books. They can report any irregularity to the high executives, and under the Sarbanes Oxley act, they are not entitled, but obliged to stop giving legal advice if they consider that the company's directors are not willing to fix the problems that they have spotted.

3. Creditors: all creditors, but specially banks must revise deeply the company's financial situation before agreeing to grant loans and financial support. A clean credit

[48] Supra Note 32
[49] Supra Note 32

history will allow the bank to protect not only the resources of its customers and the financial system itself, but also the company form spending more money than what it earns, and thus, from falling into insolvency or bankruptcy.

4. Investors: responsible investment is the key of the XXIst century. The idea of the careless investor who only provides money and waits for results has been revaluated by the corporate crisis of the last decade. The new role that must be played by the investors is as active participants in the company's activity. This will allow them to protect their money whilst vigilating the transactions.

Global Crossing's fall could have been avoided if the aspects studied through this text were taken into account. These lessons have been learnt by regulators all over the world, companies, investors and the public in general. In the coming recession it will be seen if the measures taken are enough and effective in preventing further corporate collapses.

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