Corporate Malfeasance and the General Counsel

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* VIEWS ARE MY OWN, NOT THOSE OF MY EMPLOYER
Overview: Corporate malfeasance impacts individuals as well as corporate entity

Corporate Malfeasance = Bad acts attributable to the corporation

* Bad acts include illegal as well as unethical behavior
* Attributable because undertaken at senior level, or because it’s pervasive
* Individual bad actor only problematic if corporation comes to ‘own’ the behavior

Consequences = Potentially Far Reaching

* Fines and other civil penalties, criminal penalties (effectiveness is for another day), ongoing restrictions or increased oversight
* Reputational damage to company, damage to brand
* General Counsel can be liable, often suffers reputational damage even if not implicated

GC Challenge = Ethics & Advice Not Enough

* Recent events
* Framework to recognize triggers and avoid malfeasance
## Framework: The Three B’s

### Business Model
Business metric (new accounts, prescriptions) drives success

+ Lack of incentives for countervailing actions
+ Weak or similarly incentivized oversight

⇒ Malfeasance in form of consumer fraud, regulatory failures

### Behaviors
Negative event (may be manageable on its own)

+ Avoiding disclosure
OR
+ Negligent lack of attention

⇒ Malfeasance in form of securities/accounting fraud, business or investor lawsuits

### Buried Risk
Successful business

+ Failure to recognize landscape changes
OR
+ Failure to see system risks

⇒ Malfeasance in form of systemic harm, including environmental or physical harm
Business Model – Unbalanced focus on metrics of success skews incentives

Volks wagen

- Success of diesel engine
- Pressure to continue success
- Installed software to cheat emissions tests (a “defeat device”)

- Exposed by data discrepancies
- Vehicle recall, stock price, CEO and execs resign or suspended
- Private and public actions for fraud in multiple jurisdictions, leading to fines, prison time

- No obvious public criticism or liability, although role of US counsel changed to exclude legal and include only public affairs
- Top compliance officer indicted 2017, pled guilty saying he was coached to lie by a high-ranking lawyer

Wells Fargo

- Success offering multiple financial products to retail customers
- Intense pressure on managers for sales against aggressive quotas
- New accounts, phantom insurance, or moved funds without client’s knowledge

- Exposed as fraud when clients charged unanticipated fees or can’t find money
- CEO and many (incl. low-level) employees fired, stock price decreases
- CFPB action, fines, restitution, plus penalties and increased oversight from regulators

- New General Counsel hired in 2017 (previous GC retired)
- Legal department said not to “discuss or appreciate seriousness and scale of sales practices issues”
Behavior – Negative event worsened by cowardice or bad actions

**Uber**
- Data breach / hack in 2016 impacted both customers and drivers (including driver’s licenses)
- Rather than notifying and mitigating, paid hackers to delete stolen data
- Exposed by internal board of directors investigation, part of overall corporate integrity efforts
- Still playing out; potential suits by US attorney general, class actions, possible FTC action

**Equifax**
- Data breach / hack affecting multiple customers in sensitive area (credit reporting)
- After hack and prior to disclosure, a “handful of highly placed Equifax executives went on a stock selling spree”
- Stock sales were approved by top lawyer
- CEO stepped down, negative impact on sales and business, decreased stock price
- Suits from state attorneys general, as well as private class actions, SEC subpoena

- Previous GC already had been replaced; she “hadn’t been told about the incident” (whether not knowing is a good or bad fact is publicly debated)
- Senior in-house attorney fired along with Chief Security Officer (to whom the attorney reported)
- Chief Legal Officer was responsible for “security, compliance and privacy.” He still has job, but someone else is now the “Chief Transformation Officer” and responsible for overseeing him
Buried Risk – Ethically questionable actions accepted in defined industry

**Banking Industry**
- Securitized mortgages were bought and sold based on a risk picture that didn’t account for systemic changes in underlying asset market
- When underlying market shifted, financial instruments suddenly lost value, leading to a widespread collapse
- In retrospect, failure to appreciate risk was negligent, not a result of unknowable risks
- Issue exacerbated by ethically questionable practices such as banks being on both sides of certain transactions
- Although lawyers drafted instruments, none held directly responsible

**Opioid Distributors**
- Despite promise for controlling pain, addiction and off-label use of opioids has led to a public health crisis leading to disability and death
- Over-prescription is widespread. For example, in Ohio the amount prescribed was enough for 68 pills for every individual in the state
- Lawsuits charge that companies misstated risks and benefits in marketing
- Distributors, insurance companies and others also may be liable, based on argument that they should have done simple math to see excess of prescriptions
- Will lawyers for portions of system be implicated for failure to appreciate systemic risk?
- Multiple layers of contracting, including payors and insurance companies, distributors, marketers and manufacturers involve legal support, particularly in a highly regulated industry
GC’s role in preventing and mitigating corporate malfeasance

Changing Norms

- Historical defenses for the in-house legal department (e.g., Enron)
  - Didn’t know
  - Outside scope of responsibilities
- No longer adequate
  - Wells Fargo internal report: Lawyers and Board didn’t probe enough
  - Commentary on Uber scandals: How could they not know? (GC replaced despite lacking involvement)
  - Yahoo security breach: General Counsel out

New Rules

- Take seriously and entirely fulfill any oversight function
  - Equifax GC seeming failure to take seriously role to approve securities purchases during window
  - If GC includes “head of security,” then must accept full responsibilities
- Proactively review risks, including with involvement of outsiders
Reviewing malfeasance risk for 3 B’s

**Business Model**

*Difficulty: Often central to success of the business, so there may be many layers of mixed incentives*

- Review incentive compensation in larger context; active compliance function may be needed (e.g., many pharma companies)
- Avoid fiefdoms where risk is managed in small insular group; centralize legal function and rotate players so risk-assessor is not beholden to ‘client’ for employment or compensation
- Goal is culture of compliance

**Behaviors**

*Difficulty: Where situation feels dire or threatening, natural reaction is to hide it*

- Employees must know rules and proper responses for known risks (e.g., security breaches)
- Oversight functions must be empowered to manage or to report to senior management
- Training

**Buried Risk**

*Difficulty: Risk is systemic in industry, not just organization*

- Requires assessment by third party or individual not steeped in core business of company
- Beware of “but they just don’t understand our industry or our challenges” (it won’t matter when the facts are publicly known)
Thank you!