



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

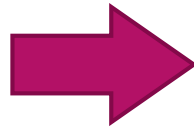
+ Failure to see system risks

→ 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”)

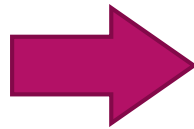


- Exposed by data discrepancies
- Vehicle recall, stock price, CEO and execs resign or suspended
- Private and public actions for fraud in multiple jurisdictions, leading to fines, prison time

- 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



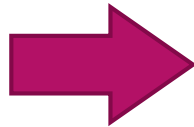
- Exposed as fraud when clients charged unanticipated fees or can’t find money
- CEO and many (incl. low-level) employees fired, stock price decreases
- CFPB action, fines, restitution, plus penalties and increased oversight from regulators

- 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

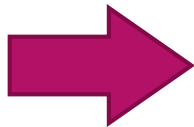


- Exposed by internal board of directors investigation, part of overall corporate integrity efforts
- Still playing out; potential suits by US attorney general, class actions, possible FTC action

- 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)

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



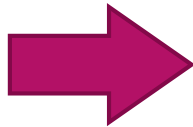
- CEO stepped down, negative impact on sales and business, decreased stock price
- Suits from state attorneys general, as well as private class actions, SEC subpoena

- 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

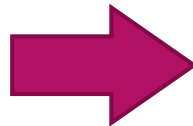


- In retrospect, failure to appreciate risk was negligent, not a result of unknowable risks
- Issue exacerbated by ethically questionable practices such as banks being on both sides of certain transactions

- 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!