

Current Issues in Business Ethics – 2021

Boz Bostrom, CPA

Professor of Accounting and Finance
College of St. Benedict / St. John's University
bbostrom@csbsju.edu (612) 414-9629

January 12, 2021

Objectives

- Understand ethical challenges raised by COVID – Confidentiality
- Understand ethical challenges raised by COVID – Due diligence
- Ethical decision making when neither alternative is a good one
- When do appropriate gifts and entertainment shift to conflicts of interest and bribery?
- Doing your due diligence, even when everyone says you don't need to
- Speaking up even when it is difficult
- Protecting consumers amidst uncertainty

Understand ethical challenges raised by COVID – Confidentiality

Case study

- You are working at home due to COVID-19
- Your home is not setup well for confidential work – all bedrooms are spoken for and your spouse/partner and three teenage children are roaming around the house quite a bit during the day
- A client has requested a call to discuss some sensitive changes to their operations
- Does having your family in the house impair your ability to maintain confidentiality? What do you do?

Brian Fettner

- Sports agent
- Things appear to be going well
- Many high profile clients
- Loans over \$250,000 to Jordan Reed, who becomes a 3rd round draft pick
- Expands from Florida to Vegas. Needs a house in Vegas because the travel is stressful
- Builds a \$4M house in Vegas
- Dog shower, dog spa tub



Things begin to unravel

- Jordan Reed, is about to cash in on a huge payday - \$50M
- Reed switches agents
- Fettner sues Reed for the \$250,000, including interest

Meanwhile

- December 2015. Cintas approaches G&K Services about an acquisition
- June 2016. Cintas' General Counsel takes home merger related documents and leaves them on the desk of his home office
- Fettner stays at GC's home when he was in town for a charity golf event
- Fettner goes into GC's home office to change into golf shoes. Sees/reads merger documents

Brian Fettner / G&K Services

- Girlfriend purchases about \$20,000 worth of shares
- Father purchases about \$150,000 worth of shares
- Purchased \$16,000 worth of shares in an ex-girlfriend's account
- Purchases \$750,000 worth of shares in ex-wife's brokerage account.
- August 2016. Acquisition is announced and stock price shoots up 18%
- At least \$250,000 of illegal profits

Polling question #1: If you could talk to one of the parties in this case, who would it be?

- A. Brian Fettner
- B. Ex-wife
- C. Jordan Reed
- D. Someone else

Linklaters

- Linklaters is a global law firm, with nearly 3,000 lawyers and partners working in 30 offices in 20 countries
- Menglu Wang graduated from Harvard Law and began working for Linklaters in 2015
- Fei Yen
 - 31 year old MIT research scientist



Linklaters

- Wang worked on transactions where her clients were acquiring publicly-traded companies
- Yen obtained information about the transactions, setup a brokerage account under mother's name, and traded
- About \$120,000 of profits

Linklaters

- SEC noticed unusual trades and investigated Yen
- Found various google searches:
 - “how sec detect unusual trade”
 - “insider trading in an international account”
 - Article - “Want to Commit Insider Trading? Here's How Not to Do it”

Linklaters

- July 2017 – Yen arrested
- March 2018 – Yen sentenced to 15 months in prison and must forfeit the \$120,000
- Wang – suspended, then fired from Linklaters
- Her lawyer: “There were a number of innocent bystanders. She is one of them. It’s an unfortunate side effect that she lost her job.”
- How were Yen and Wang affiliated?
- They were married!

Confidentiality concerns – heightened due to COVID

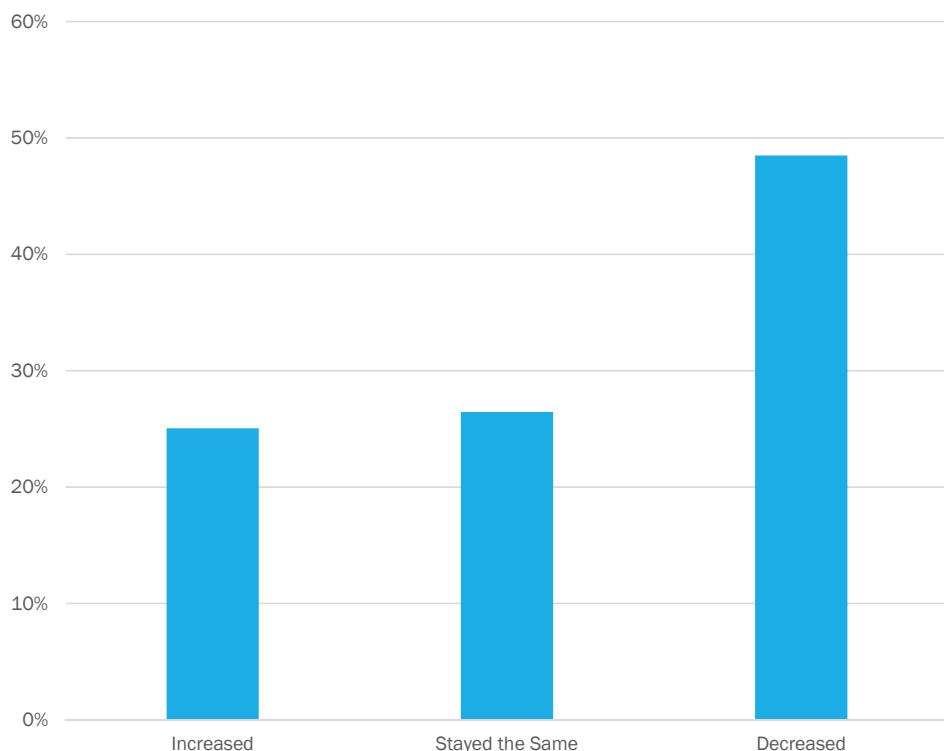
- Security of physical files
- Security of electronic files, laptops and phones
- Phone conversations
- Zoom meetings – general security
- Zoom chats – may be saved
- Others?

Understand ethical challenges raised by COVID – Due diligence

Discussion Questions - Compared to pre-COVID

- Has your communication with clients increased or decreased?
- Has your communication with colleagues increased or decreased?

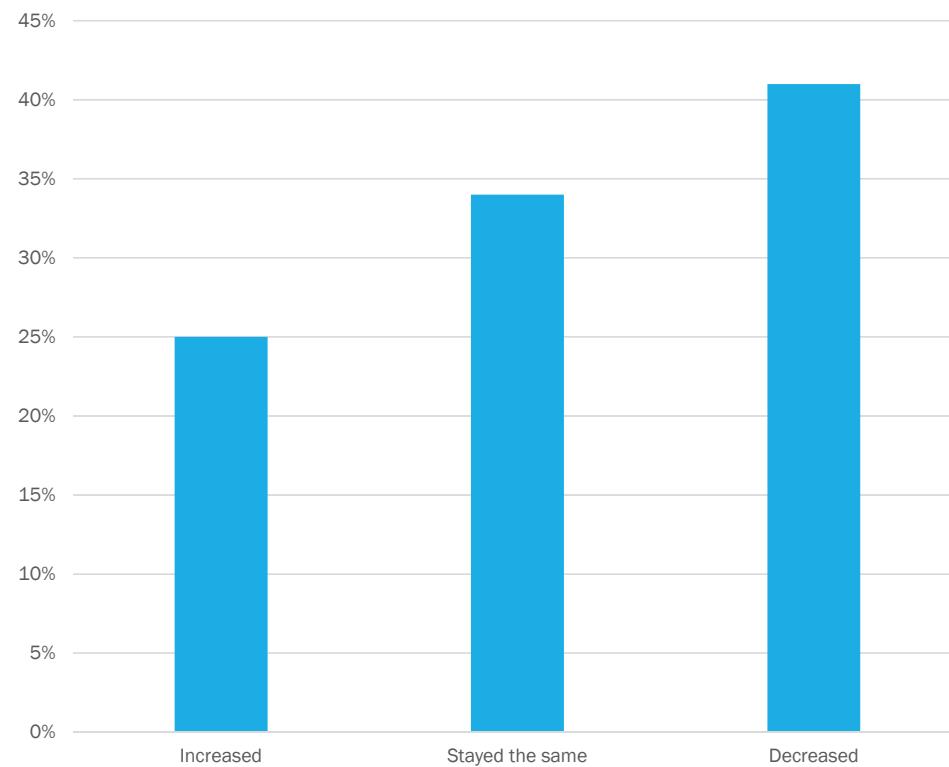
May 2020 survey of 525 business professionals. How has your communication with Co-workers and clients changed?



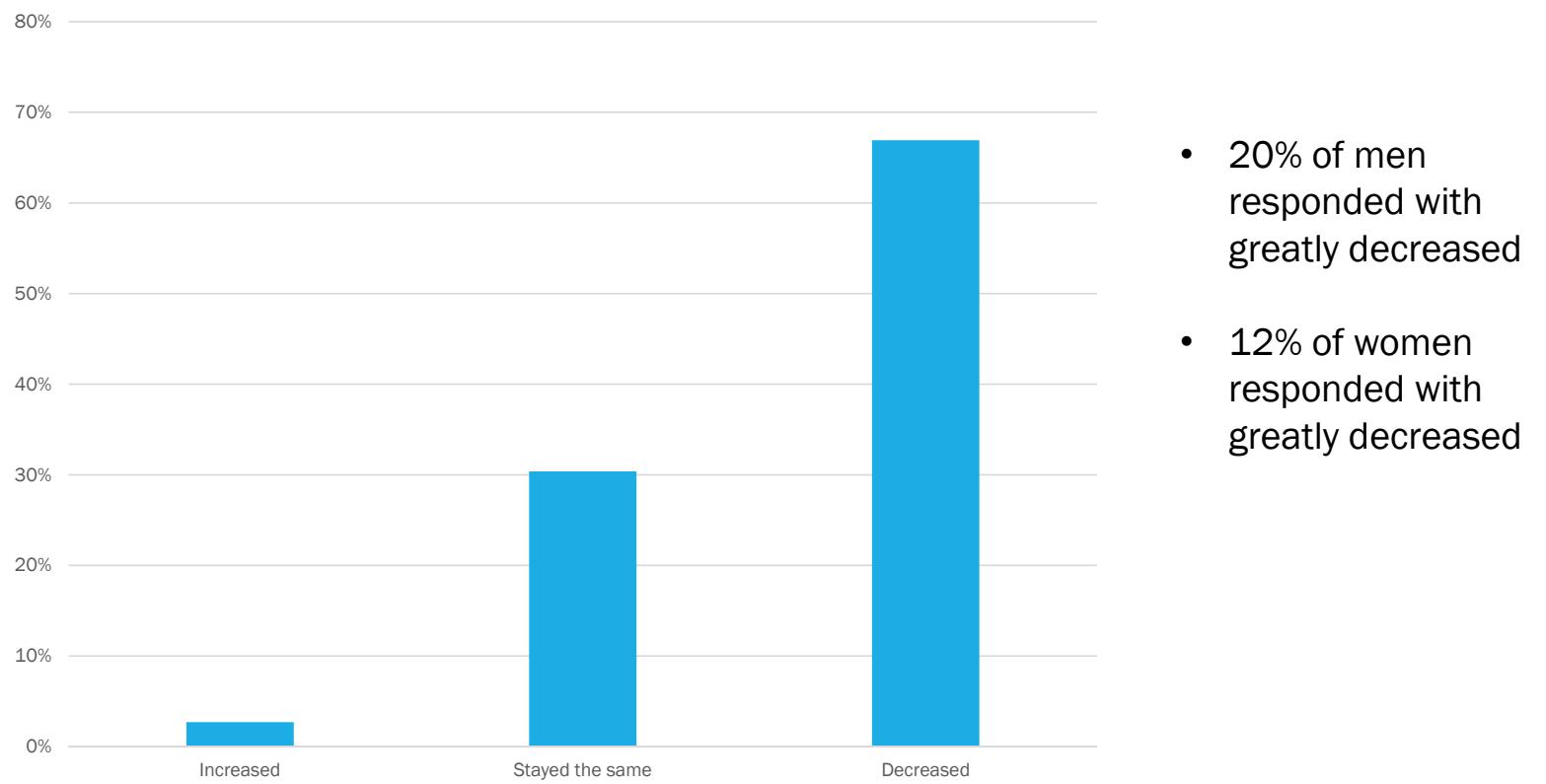
- Women increased 27%, men only 23%
- Men decreased 51%, women only 46%
- Several comments that communication with co-workers decreased but with clients increased

July 2020 survey.

How has your communication with colleagues changed since about May 1st?



October 2020 survey of 613 professionals. Compared with pre-COVID, my connection with colleagues has:



Are clients receiving the communication they deserve?

- Pros
 - Virtual platforms have existed for some time, but they were not widely used. Compared to phone/conference calls, the ability to share screens and bring groups together is a significant improvement
 - More flexibility in meeting times
- Cons
 - Struggle for those who prefer in-person discussion

Case study

- You are working at home and preparing a proposal for a client
- You would normally bounce your conclusion to this issue off a certain colleague but you know they are feeling very overwhelmed.
- Your colleague is trying to balance their own work, the schoolwork of two grade school children who are now completely online, depression of their spouse who is trying to find work after their job was eliminated, financial stress, and general anxiety about COVID and political unrest in our country.
- Do you reach out to your colleague for advice on the issue involving your client?

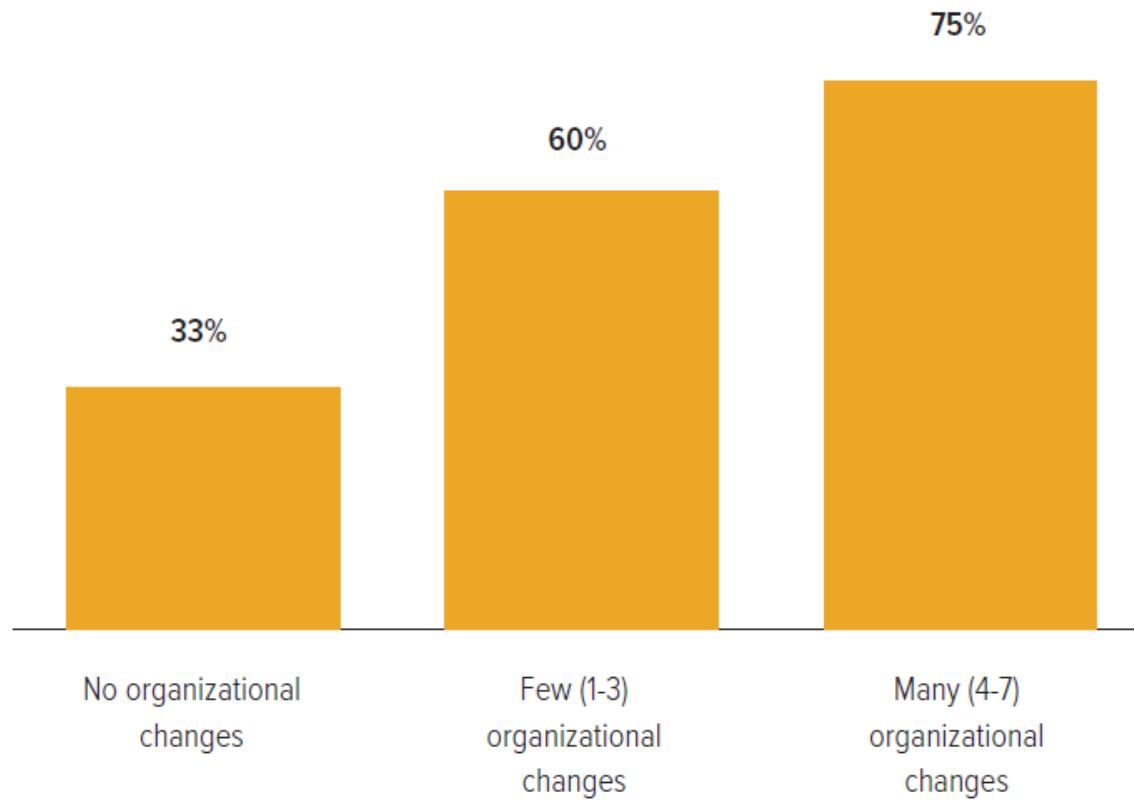
Are we acting with competence and diligence?

- Pros
 - Resources which have long been available but underutilized are becoming more necessary
 - More discussions with colleagues in other locations, and not just colleagues in close proximity
- Cons:
 - Short conversations are still available, but as they aren't as natural, they are not happening as much
- Actions
 - Allow time for casual conversation, which may turn in to other discussion
 - Create a culture of encouraging questions, especially among those who may need more guidance – newer to the professional or a client/industry

Impact of significant organizational changes on observed misconduct

- Do significant changes lead to higher observed misconduct?
- First, define significant changes, 7 categories:
 - expanded operations into new countries and/or markets
 - merged with another organization
 - acquired another organization
 - was acquired by another organization
 - experienced changes in top management
 - implemented layoffs, restructuring, and/or downsizing
 - implemented cost-cutting measures

Observed Misconduct Rises with an Increase in Organizational Change



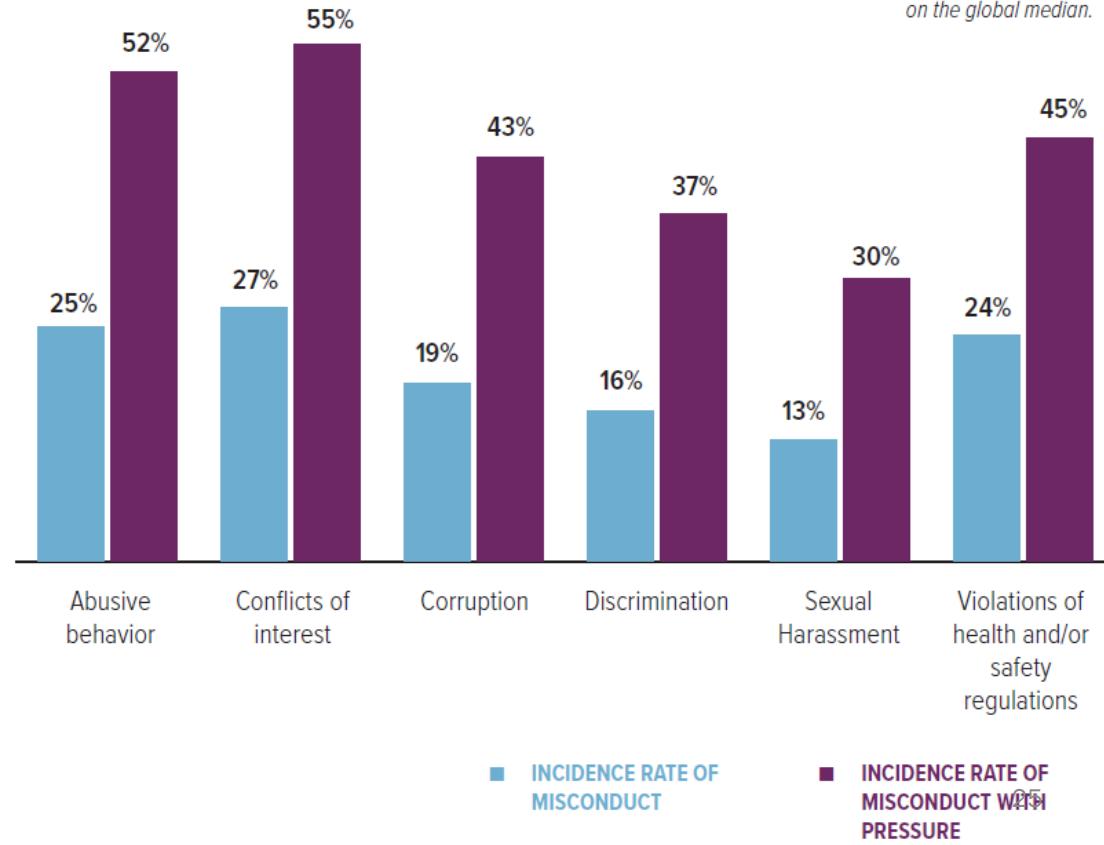
- Question...will COVID lead to more organizational changes and thus more misconduct?

Pressure/ Misconduct

- Globally, 22% of Employees Feel Pressure to Compromise Their Organization's Ethics Standards, Policies or the Law
- Only 13% when leaders had a strong Commitment to Organizational Values and Ethical Leadership
- 25% for moderate commitment, 49% for weak

Employees Who Feel Pressure Are About 2X as Likely to Observe Various Types of Misconduct

Percentages shown are based on the global median.



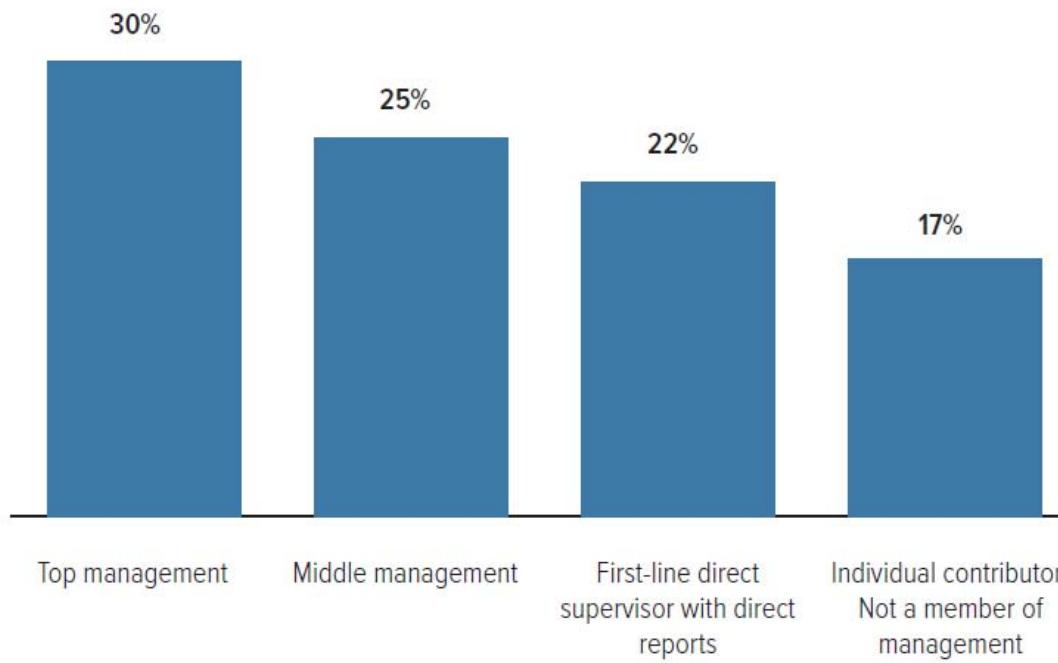
Polling question #2: What level within an organization feels the most pressure to compromise their ethics?

- A. Top management
- B. Middle management
- C. Supervisors
- D. Entry level

Pressure higher at higher levels

The Incidence of Pressure Was Almost 2X as High Among Top Management
Compared with Individual Contributors

*Percentages shown are based
on the global median.*



Ethical decision making when neither alternative is a good one

Case study

- Business has been fairly slow and lines of credits are maxed out
- You are forecasting cash flow for next month and you see that you will be able to make payroll payments to employees, but not remit withheld taxes to the government
- You feel that if you can buy the company some time, it will be able to right the ship and get caught up on payments
- What should you do? What is the risk of not making the payments?

College of New Rochelle

- Liberal arts college with 3,000 students
- 115-year history – 50,000 graduates
- Announced in February 2019 it would be shutting down
- Sold for \$32M in November 2019 to a group known for operating nursing care and retirement community
- How did it get to this point?



Keith Borge

- Long time employee at the college. Was controller from 2014 – 2016.
- Withheld income and payroll taxes from employees - Federal law requires payment within 1 week
- From Q3 of 2014 through Q2 of 2016, failed to pay \$20m of tax withholdings to federal and state governments



Keith Borge

- June 30, 2015 financials showed net assets of \$25M when they should have been close to zero
 - \$11M of unrecorded payroll tax liabilities
 - Overstated receivables by \$9.2M, recognizing pledges twice
 - Understated accounts payable by \$1.5M, failed to record unpaid invoices
 - Printed checks but did not mail them
 - Employee discovered this and was fired by Borge
 - Overstated investment assets by \$2.2M – assets which did not exist or which had been withdrawn
- Drew down \$5M on grants for expenses not authorized by the grants

Keith Borge

- College announced an investigation in October 2016
 - President of 5 years resigned in 2016, had been a Big 4 audit senior manager
- Keith pled guilty in March 2019 to securities fraud and failure to pay payroll taxes
- Guidelines were 8-10 years of prison and a \$300,000 fine
- August 2019 (when Keith is 63 years old) – sentenced to 3 years in prison, 3 year supervised release, and \$25,000 fine
- Released after one year in prison and moved to home confinement
 - due to COVID

Defense “strategies”

- Attempted to deflect attention from himself saying a senior accountant was recording the liabilities
- Portrayed himself as a hero, as he did not personally benefit from the financial manipulations and his actions permitted more than 5,600 students to obtain degrees
- Indicated he pled guilty for “the sins of others”
- "I have always had to deal with money problems. I was just trying to keep the college going. It meant so much to me. I hoped things would get better."
- Judge: "It's clear to me that the defendant didn't gain anything from this. Then the question is why do it? The answer is murky, It's not easy to answer. But it's clear that the college closed because the mountain of debt was too steep to climb."

When facing a decision with no good answer

- Communicate as soon as possible with affected parties
- Maintain forecasts to identify problems as far in advance as possible
- Weigh legal requirements vs. personal ethics

When do appropriate gifts and entertainment shift to conflicts of interest and bribery?

Case Study

- You are seeking to win the business of a new major client
- The client enjoys being entertained and you are considering what gifts/entertainment would be considered proper
- Can you take the client out to lunch?
 - How about a lavish dinner?
 - Could you give the client an expensive gift card to a fine steakhouse?
- Can you take the client to a sporting event?
 - What if it a major event like a World Series game?
 - Can you simply give tickets to your client?

Polling question #3: When evaluating a conflict of interest, you should consider:

- A. The opinion of a reasonable and informed third-party
- B. The opinion of a reasonable and informed related party
- C. The risk your action will be discovered
- D. The opinion of unethical colleagues

Conflicts of Interest

- Consider the reasonable and informed third party standard
- What would a competitor who knows about your actions think of them?

Conflicts of Interest

- Identify a conflict of interest
 - Nature of services/relationships
- Evaluate a conflict of interest
 - Significance of threat/safeguards
 - If not at acceptable level, must apply more safeguards
 - Restructuring or segregating certain responsibilities and duties
 - Obtaining appropriate oversight
 - Withdrawing from the decision-making process related to the matter giving rise to the conflict of interest
 - If can't get to acceptable level, decline services or withdraw from the relationship
- Disclose a conflict of interest (if at acceptable level)
 - To relevant parties – threat and safeguards
 - Documentation

Valeant Pharmaceuticals / Philidor The Players

- Gary Tanner
 - Senior direct at Valiant
- Andrew Davenport
 - Founder of Philidor
- Valiant – a \$10B Canadian Company
- Philidor
 - Founded around 2013
 - Mail-order pharmacy – distributed for Valiant



Valeant Pharmaceuticals / Philidor

The Problem

- Tanner / Davenport began talks in 2012 about creating a specialty pharmacy
- Tanner was supposed to build up Philidor as well as other pharmacies
- Tanner did not build those relationships with other pharmacies
 - Increased the value of Philidor
- In 2014, Valeant paid \$133M for an option to purchase Philidor (in 10 years)
 - Davenport profited \$40M
 - Kicked-back nearly \$10M to Tanner / Tanner paid taxes on the windfall
- Throughout the relationship, Tanner used a shell company and a fake name – Brian Wilson

Valeant Pharmaceuticals / Philidor

The Fallout

- Tanner's boss became suspicious and tipped off the CEO that Tanner may have a stake in Philidor. CEO did not act
 - Taped the conversation
- Valeant disclosed the relationship in 2015 and then severed ties with Philidor
- Tanner / Davenport each sentenced to a year in prison
- CEO ousted, but asked for 3 million shares of severance!
- Valeant Renamed Bausch (& Lomb) Health
 - Combined with other issues, lost 90% of share value, about \$100B, in one year

IRS Criminal Investigations Report (2020)

Dallas Field Office - Highlights

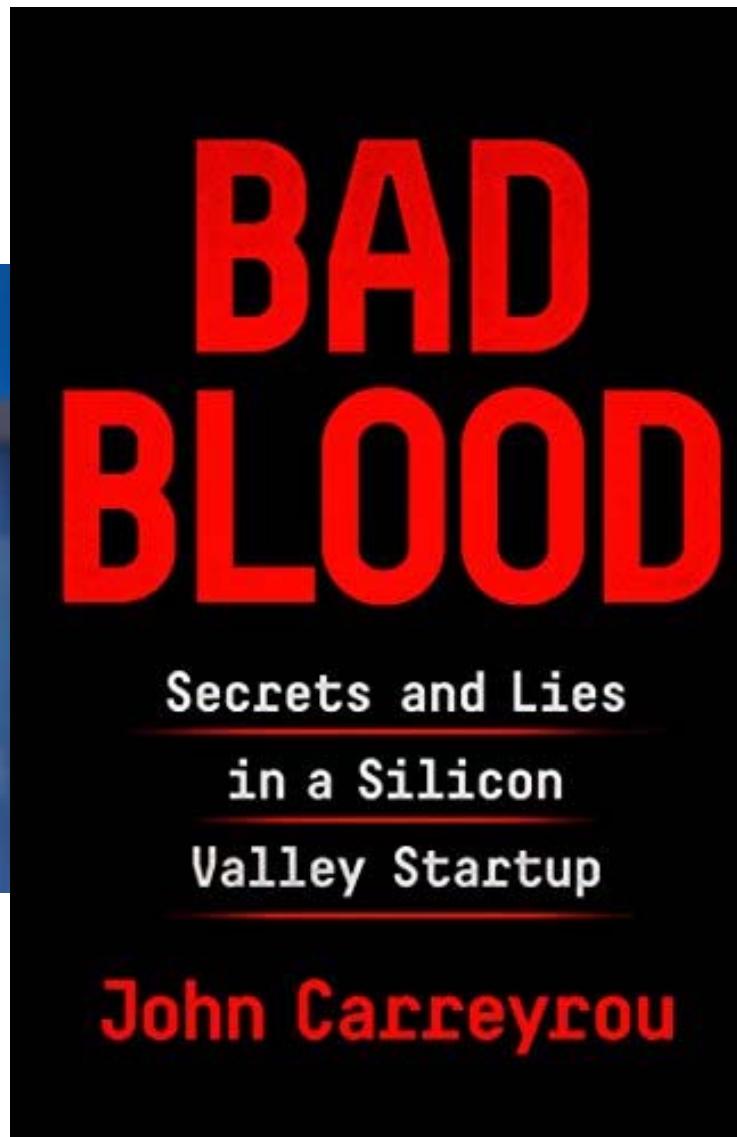
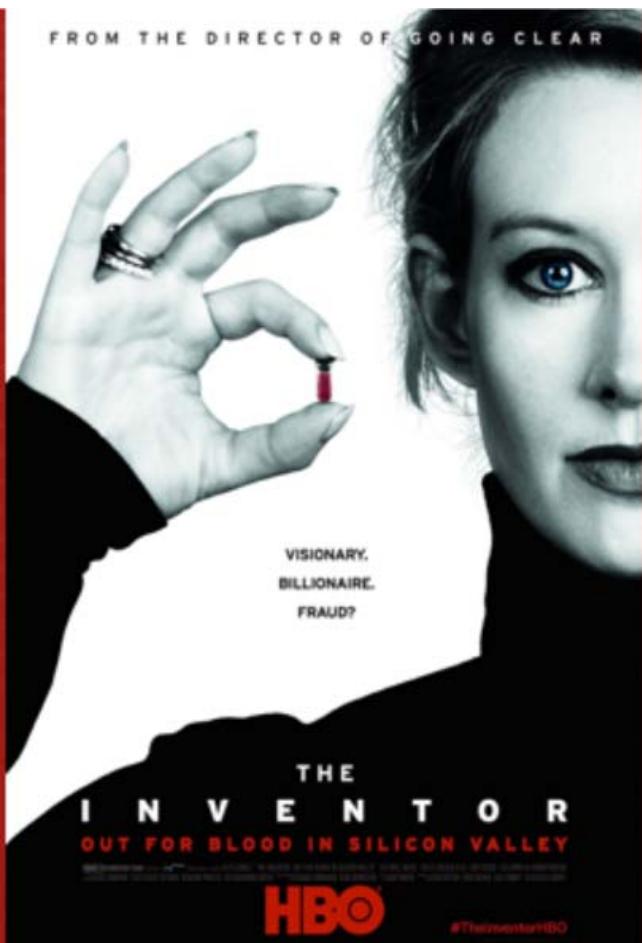
- Dwaine Caraway, former Mayor of Dallas
- Accepted \$450,000 worth of bribes in exchange for supporting products produced by a vendor
- In addition to cash, custom-made suits, fully funded trips, casino chips, fake loans, and funeral expenses
- Did not pay taxes on of the bribes
- Sentenced to 4 ½ years in prison

**Doing your due diligence, even
when everyone says you don't
need to**

Case Study

- You are considering the acquisition of another agency, whose leader is looking to retire
- The other agency will not provide you with information you normally would like for your due diligence, and is requesting a simple approach to compute the value based on what they tell you are the annual premiums of their business
- The other agency has many well-known clients, who you think could help you attract more business
- How hard do you push for more information in your due diligence?

Theranos / Elizabeth Holmes



Timeline

- Founded in 2003 by Holmes, a Stanford dropout
- Claimed it had a product which could run blood tests from a finger prick
 - Would save dollars and get results to patients more quickly
- Over \$700M raised from investors - \$9B valuation
- Major partnerships with Walgreen's and Safeway

Board of Directors

- Channing Robertson, a chemical-engineering professor at Stanford
- George Shultz (former Secretary of State)
- William Perry (former Secretary of Defense)
- Henry Kissinger (former Secretary of State)
- Sam Nunn (former U.S. Senator)
- Bill Frist (former U.S. Senator and heart-transplant surgeon)
- Gary Roughead (Admiral, USN, retired)
- James Mattis (General, USMC, later Trump's Secretary of Defense)
- Richard Kovacevich (former Wells Fargo Chairman and CEO)
- Riley Bechtel (chairman of the board and former CEO at Bechtel Group)

Problems

- Many people within the company and at customers/investors raised red flags that the products did not work as advertised
 - Fired
 - Nondisclosure agreements
 - Threatened with lawsuits
 - Suicide
- CEO/founder in a secret romantic relationship with company's President
- Began to unravel with October 2015 WSJ article
 - Company's products not accurate
 - Company used competitors' products

Charges

- SEC report in March 2018
 - “Massive fraud”
 - Company claimed it had \$100M in revenues. Actually was \$100,000
 - Holmes settled - \$500k fine, forfeiture of (worthless) shares, barred from leadership positions with a public company for 10 years
- June 2018 - Charged with wire fraud and conspiracy to commit wire fraud
 - “Investors and doctors and patients were defrauded.”
 - “Defendants were aware of the unreliability and inaccuracy of their products, but concealed that information”
 - Up to 20 years in prison
- Trial to begin in June 2021

**Speaking up even when it is
difficult**

Case Study

- You are a newer employee at your agency
- You notice that a senior agent has been misleading clients when explaining policies
- This senior agent is the highest producer at the agency, outperforming even the owner
- What options do you have and what are pros/cons of each?

David Colletti / MillerCoors



- Began work for Miller Brewing in 1982
- Ultimately became VP of on-premises marketing
- On-premises marketing is promoting sales to restaurants, bars, stadiums, and other venues which sell beverages for consumption on site

Timeline

- Fraud occurred from 2003 to 2013
- Shell companies were formed and billed Miller Coors for services/events which were not performed, or at inflated prices
- More than 200 payments to 15 vendors. Over \$8 million in total in fraudulent payments
- Colletti and his friends used funds for:
 - international golf trips and hunting trips
 - firearms collection
 - investment in a hotel
 - Investment in an arena football team

Timeline (continued)

- 2014 – MillerCoors sues Colletti and 7 others
- 2015 – Colletti and 7 others federally indicted
 - Pleads not guilty
- 2016 - Pleads guilty and will help government in investigation against others
- 2019 – Sentenced to 3 ½ years in prison, after cooperating with government. Restitution of the \$8 million

The unraveling

- September 2013 - an employee noticed an address of the shell company was the same as that of an employee
- Auditors then focused on:
 - 1. vendors that Colletti added
 - 2. payments that Colletti approved
- When apologizing, Colletti indicated he desired to keep up with the “rat race”

Polling question #4: What alarmed you most about this case?

- A. The dollar amount of the fraud
- B. The length of the fraud
- C. The investments chosen by David
- D. The simplicity of the fraud

Protecting consumers amidst uncertainty

Case Study

- A business has a long-time and profitable product which suddenly has been accused of causing health risks
- The business is continuing to study whether the product indeed causes these health risks
- What should the business do?
 - Continue selling the product as normal
 - Discontinue selling the product
 - Something else?

DeWayne Johnson

- School Groundskeeper in the Bay Area
- Used Round-Up from 2012-2015
 - No warning on product that it could cause cancer
- Got “drenched” with it a couple times
 - Called consumer hotline – call not returned



Meanwhile

- September 2016 – Bayer announces plans to acquire Monsanto for \$66 billion
- June 7, 2018 – Deal closes. Bayer's stock price at about \$27 per share

The Verdict

- August 2018 – Jury awards \$289M to DeWayne Johnson
- “The jury found unanimously that Monsanto’s glyphosate-based Roundup weed killer caused Mr. Johnson to develop NHL, and that Monsanto failed to warn of this severe health hazard. Importantly, the jury also found that Monsanto acted with malice, oppression or fraud and should be punished for its conduct.”
- October 2018 – Judge reduces award to \$78M
- June 2020 – On appeals, reward reduced to \$21.5M
- Monsanto considering a further appeal to Supreme Court

Continued Fall-out

- A jury awarded another couple \$2 billion, since reduced
- Monsanto will settle 125,000 cases for \$10 billion
- November 2020– stock around \$14 per share
 - 50% decline in value (over \$50 billion) since Monsanto was acquired
 - S&P up 20% over Since Bayer's acquisition of Monsanto

Opportunity = Extortion

- Two Virginia attorneys were finding mass tort clients – defendant would be one of Monsanto's chemical suppliers
- Attorneys asked for \$200M in consulting fees to keep the case quiet.
- Would not share fees with clients and would stop representing clients due to a conflict of interest
- Attorneys sentenced to two years and one year in prison



Timothy Litzenburg · 3rd
Mass tort trial lawyer
Richmond, Virginia, United States · 1

The screenshot shows a red header with the "NATIONAL TRIAL LAWYERS" logo. Below the header, there is a navigation bar with links for "Home", "About", and "Membership". On the right side of the header, there is a "Find A Lawyer" search bar. The main content area features a large photo of a smiling man (Daniel Kincheloe) in a suit. To the right of the photo, his name "Daniel Kincheloe" is displayed in bold text, followed by the text "Kincheloe, Litzenburg & Pendleton, PLLC". Below the photo, the word "Partner" is written. On the far right, there is a gold circular badge with the text "MASS TORT TRIAL LAWYERS" and "TOP 25".

Now what?

- CostCo has pulled RoundUp off its shelves, but many vendors still sell it

The image shows a screenshot of an Amazon product page for Roundup Weed and Grass Killer Concentrate Plus. The product is a white plastic jug with a red flip-top lid, labeled '12 Gallons' and 'Roundup WEED & GRASS KILLER CONCENTRATE PLUS'. The page includes a sidebar with five thumbnail images and a video player, a search bar at the top, and a promotional banner for the Summer store.

Roundup Weed and Grass Killer Concentrate Plus, 36.8-Ounce
by Roundup
★ ★ ★ ★ ★ 737 customer reviews | 85 answered questions

List Price: \$25.49
Price: \$18.00 ✓prime
FREE Shipping on orders over \$25—or get FREE Two-Day Shipping with Amazon Prime
You Save: \$7.49 (29%)
In Stock.

Want it Wednesday, May 29? Order within 1 min and choose Two-Day Shipping at checkout. Details
Ships from and sold by Amazon.com.

Size: 36.8-Ounce
16-Ounce \$12.92 36.8-Ounce \$18.00 0.5 GAL \$36.88

Kills the toughest weeds and grasses to the root. Guaranteed!
For use in a tank sprayer
For use around flowers, shrubs and trees; on patios, walkways, driveways, gravel areas and mulch beds; along fences, edging and foundations; as well as large areas such as lawn replacements or garden plot preparation. Not for use around existing edibles.
Rainproof in 30 minutes
Visible results in 12 hours with FastAct Technology

Compare with similar items
New (11) from \$18.00 & FREE shipping on orders over \$25.00. Details

Final tips

- Understand and anticipate ethical pitfalls caused by COVID
- When facing conflicts of interest and making other tough ethical decisions, focus on the long-term
- Assume others will find out about your decision