

Courting Disaster: When CEOs Circumvent Their GCs

By **Sue Reisinger**

Law360 (October 6, 2020, 7:12 PM EDT) -- When CEOs try to manipulate or get around their general counsel, the results can be disastrous for the corporation and for them.

In three recent examples where such conduct appears to have taken place — at Commonwealth Edison in Chicago, Rio Tinto in Australia, and Theranos in California — all three CEOs lost their jobs, and two of them are facing criminal investigations.

Preston Pugh, a partner at Crowell & Moring LLP in Washington, D.C., told Law360 such situations are not new. Pugh, a former court-appointed compliance monitor, said, "I have done a number of investigations involving people in the C-suites ... [and] a lot of times those investigations involved a situation where a leader has not listened to admonishments from legal, particularly the general counsel."

Pugh, a former assistant U.S. attorney and ex-senior compliance investigations counsel at GE Healthcare, added, "I have seen the head of a business try to circumvent a general counsel ... in a few situations." He declined to discuss those cases.

Here's how three CEOs recently in the news seemed to find ways around their general counsel to the detriment of the companies, and what experts say other GCs can do to save their corporations from a similar fate.

ComEd

In July, Commonwealth Edison Co., a unit of Chicago-based Exelon Corp., agreed to pay \$200 million and signed a deferred prosecution agreement to resolve a federal investigation into a yearslong bribery scheme.

The utility company admitted it "arranged jobs, vendor subcontracts, and monetary payments" for various associates of a high-level elected state official in return for favorable legislation. That official has been identified in news reports as Speaker of the House Michael Madigan, who has not been charged but whose conduct is under investigation by a special House committee.

One incident at issue in the ComEd case showed a CEO's clear effort to circumvent the legal department, according to a statement of facts in the agreement. The document describes how a lobbyist pressured then-ComEd CEO Anne Pramaggiore to extend a contract with an unnamed law firm favored by Madigan.

Pramaggiore, who later became CEO of Exelon, then assigned a project manager working to obtain legislative approval on a measure to "assure that Law Firm A's contract was renewed," the document says.

According to the document, "The project manager had no oversight authority over ComEd's legal department and was not otherwise involved in deciding what legal professionals the legal department retained."

Pramaggiore, who could not be reached for comment, abruptly retired from Exelon in 2019 amid the federal probe. She also resigned as chair of the Federal Reserve Bank of Chicago and remains under scrutiny as prosecutors continue investigating individuals. She has previously declined to comment to Law360 and other publications.

Rio Tinto

Avoiding the legal department unfolded differently at the Rio Tinto mining group.

There, CEO Jean-Sébastien Jacques decided in May to blast a 46,000-year-old gorge that was a sacred aboriginal site in Western Australia.

The public outcry led to an internal investigation, which showed that while the plans once went through the general counsel's office, Jacques ultimately steered the decision through the head of corporate relations, an executive committee post he had created and filled with confidante Simone Niven.

Rio Tinto has asked both executives to leave — Niven by Dec. 31, and Jacques as soon as a replacement is found.

Theranos

At blood-testing company Theranos Inc., the manipulation was more subtle.

There, CEO Elizabeth Holmes appeared to put her general counsel in a position to be easily controlled. Holmes named David Boies to the Theranos board, paid Boies' law firm as outside counsel in millions of dollars' worth of stock and hired one of Boies' underlings as GC.

Though the company was heavily regulated, general counsel Heather King had no prior experience as a GC, apparently giving Holmes unfettered control. As a result, Holmes, who has been indicted on fraud charges, allegedly lied about her company's technology and its abilities. Theranos went out of business.

Solutions

Most experts said the solution in these situations lies with strong oversight from the board of directors.

"It is super important for the general counsel to have a direct line to the board," Crowell & Moring's Pugh said. "That involves more than just litigation, but also compliance matters."

He said he has seen instances of a general counsel talking with the board without the CEO present. "That is rare," he explained, "and it won't happen if your CEO is also chair of the board."

A hotline can also be an important tool, he said. "And make sure those calls are going to someone who is a liaison to the board."

Every situation is different, but a general counsel has options, said Michael Callahan, professor of the practice of law and executive director of the Rock Center for Corporate Governance at Stanford Law School.

Callahan suggested that the GC first take issues of such magnitude to the CEO. "If ignored or bypassed, then the general counsel can take it to the chairman of the board, assuming there is a separation of the chairman and CEO," he said. "If not separated, then the general counsel can take it to the lead independent director."

Callahan suggested that the general counsel have regular meetings alone with the board and the audit committee in executive session without the CEO, giving both parties a chance to raise questions.

"Maintaining good, regular lines of communication between the general counsel and the board, even when there is no problematic situation, is best practice and builds trust in the function, and also helps the board in their oversight role," he said.

University of Pennsylvania professor Philip Nichols said he teaches both the Theranos and Rio Tinto cases in his classes on social responsibility in business and on legal studies and business ethics. Nichols also leads corporate governance and accountability at the school's Zicklin Center for Business Ethics Research.

While all three cases appear different, he said, "what might have helped in all three situations would have been to build checks and balances into the system before any problems arose."

For example, he said problems might have been avoided if general counsel "had a structural way to alert independent board members of a serious concern, or if CEOs had to go through a process that involved some sort of check" that made the input of others an important element.

Pugh also said a corporate culture that encourages feedback, even pushback, can be a key for any good company.

But if all these moves fail, the experts agreed, the general counsel's final option is simply to walk.

--Editing by Aaron Pelc.