

# Theranos Case Study: What Went Wrong?





## Objectives

- ▶ Discuss how a young college dropout hoodwinked major venture capitalists
- ▶ Discover the 8 signs of trouble that were overlooked and resulted in a \$9 Billion fraud scheme
- ▶ Explore these key questions
  - ▶ Would an effective compliance program cause the startup to fail or succeed?
  - ▶ What is the role of the compliance professional when faced with signs of fraud?
  - ▶ Is an industry that affects people's lives held to a higher standard?

# CHANGE THE WORLD WITH A DROP OF BLOOD

— Elizabeth Holmes



## 8 Signs of Trouble

## Signs of Trouble #1

### Secret Technology

- ▶ Walgreens executives were not allowed in the lab to examine data
- ▶ CMS surveyors were not aware of the secret lab
- ▶ Used “trade secrets” as their defense
- ▶ Employees worked in silos and were not permitted to share information with each other

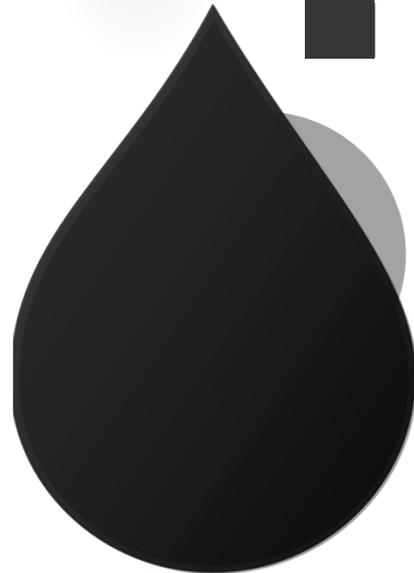
## Signs of Trouble #2

### Smitten with the new female Steve Jobs

- ▶ Forbes estimated the value at \$9 Billion (\$9,000,000,000) despite absence of scientific studies
  - ▶ Sales never topped \$100 Million
- ▶ Powerful Board members (such as former Secretaries of State George Schultz & Henry Kissinger, former General of Armed Forces James Mattis [recently Secretary of Defense], & former senator Bill Frist) overlooked obvious shortcomings
- ▶ Graced the cover of New York Post, Wall Street Journal, and Time
- ▶ Sought after speaker

# REVOLUTIONIZE HEALTHCARE!

- Elizabeth Holmes



## Signs of Trouble #3

### Culture of Retaliation

- ▶ Some employees doubted accuracy of results
- ▶ High turnover – employees were fired for disagreeing with Elizabeth Holmes
- ▶ Tyrant COO – Sunny Balwani
- ▶ Signed covenants upon termination

## Signs of Trouble #4

### Dazzled Investors

- ▶ Aggressive boasts were not challenged by investors
- ▶ Investors dazzled by Elizabeth & the potential innovation that could “change healthcare”
- ▶ Never demanded an answer to: Does this thing really work?”

ONE TINY DROP  
CHANGES  
EVERYTHING – Elizabeth Holmes



## Signs of Trouble #5

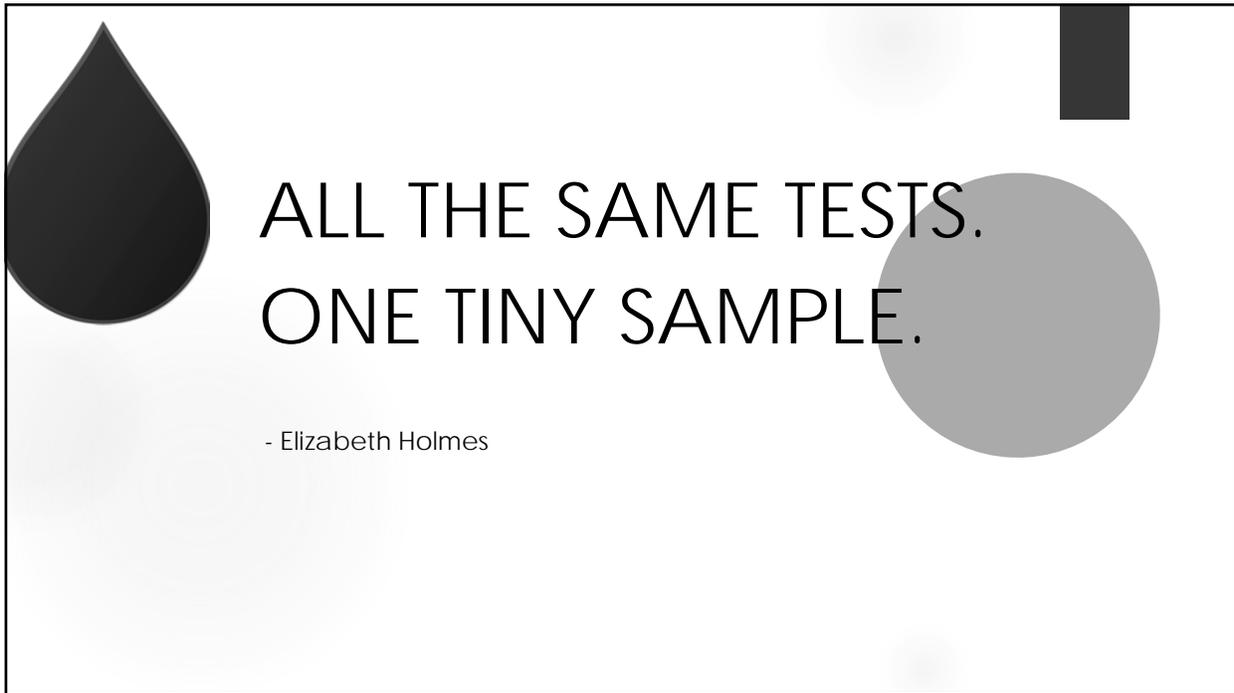
### Implied Endorsements

- ▶ Employees wrote flattering reports about company products
- ▶ Employees put logos of pharma companies on reports

## Signs of Trouble #6

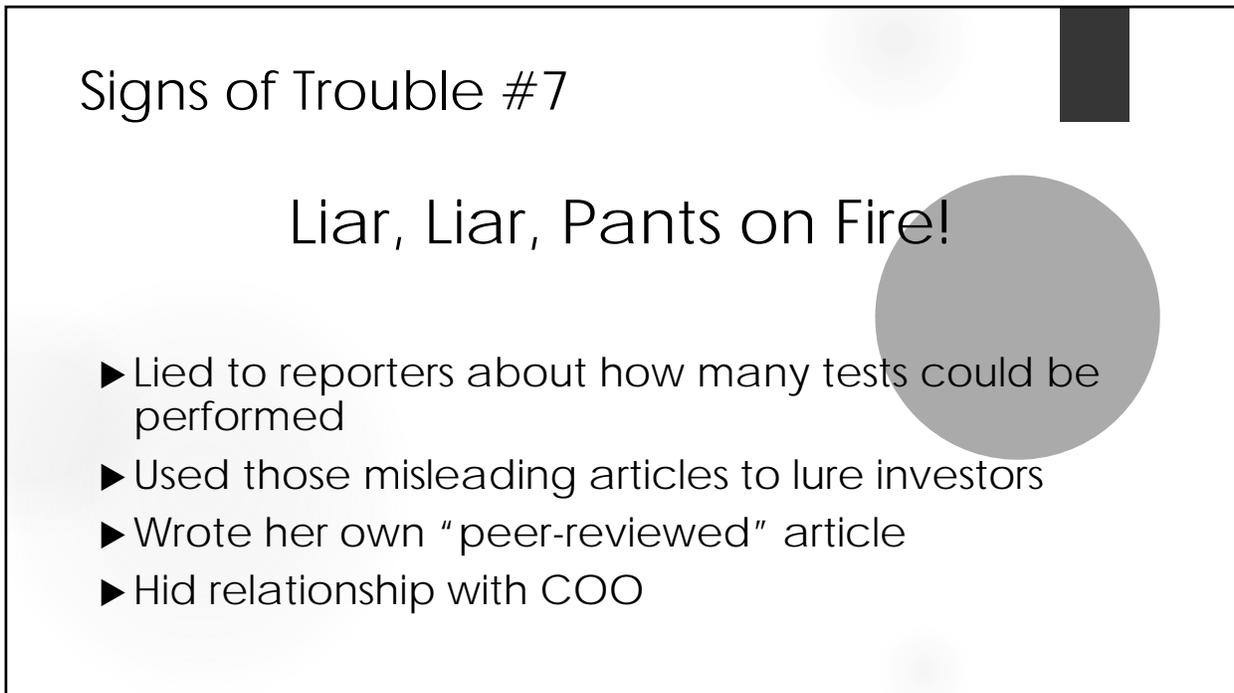
### Rolled out Defective Machines

- ▶ Received millions from Walgreens to rollout testing
  - ▶ Diagnostic tools were not ready
  - ▶ Lied to Walgreens, rather than request more time
  - ▶ In 2013, opened 42 wellness centers in AZ, 2 in CA, & 1 in PA
- ▶ Passed off 3<sup>rd</sup> party testers as its own
  - ▶ Engineers modified standard testing machines to make them look like Theranos's new "mini-Labs"



ALL THE SAME TESTS.  
ONE TINY SAMPLE.

- Elizabeth Holmes



Signs of Trouble #7

Liar, Liar, Pants on Fire!

- ▶ Lied to reporters about how many tests could be performed
- ▶ Used those misleading articles to lure investors
- ▶ Wrote her own "peer-reviewed" article
- ▶ Hid relationship with COO

## Signs of Trouble #8

### No Compliance Professional

- ▶ No compliance committee until 2016
- ▶ Elizabeth had majority shares for votes and no one to check her – founder, chairwoman, & CEO
  - ▶ Total control by founder is not uncommon in Silicon Valley start-ups

## Polling Question

- ▶ How would an effective compliance program have affected the startup's success?
  - ▶ Greater chance of success
  - ▶ Greater chance of failure
  - ▶ No impact
  - ▶ I don't know

Holmes explains the process:

A chemistry is performed so that a chemical reaction occurs and generates a signal from the chemical interaction with the sample, which is translated into a result, which is then reviewed by certified lab personnel.

Plaque on Holmes's desk:

**WHAT WOULD YOU DO IF YOU  
KNEW YOU COULD NOT FAIL?**

## Status as of January 2019

Holmes settled with the SEC for "massive fraud"

- Not required to admit wrongdoing
- Forced to surrender control of Theranos
- Banned from serving as a director or officer of any public company
- Return 18.9 million shares of stock
- Pay penalty of \$500,000

## Status as of January 2019

There is still a major criminal investigation by the FBI

Sunny Bulwani refused to settle and is awaiting trial

Elizabeth Holmes is currently soliciting investors for a new Silicon Valley start-up!

# I DON'T KNOW

-Elizabeth Holmes

-600+ times in 2017 deposition

## What would you do?

- ▶ What is the role of the compliance professional when faced with signs of fraud?
  - ▶ "Conscience of the organization"
  - ▶ Board reporting
  - ▶ Outside legal counsel

## Polling Question

▶ Is an industry that affects people's lives held to a higher standard?

- ▶ Yes
- ▶ No
- ▶ Maybe
- ▶ I don't know

## Questions?

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