CORPORATE GOVERNANCE PRINCIPLES AND SUSTAINABILITY

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Abstract

With 21st century U.S. frauds destroying well over one trillion of market capitalization and now with Valeant's 2016 market cap destruction of $86 billion, the question must again be asked: where were the gatekeepers (boards of directors, regulators, sell-side financial analysts, and auditors) to protect investors? Many of these frauds were caught only by short sellers, such as Jim Chanos (shorting Enron in 2000 and Valeant in 2014), Andrew Left (shorting Valeant in 2015), and buy-side financial analysts. Sir David Tweedy, the former chair of the International Accounting Standards Board, has commented: "The scandals that we have seen in recent years are often attributed to accounting although, in fact, I think the U.S. cases are corporate governance scandals involving fraud" (Tweedy, 2007).
This paper is a case study using the Valeant $86 billion market cap destruction in 2016 to emphasize the timeless nature of such corporate governance scandals. This scandal was even larger than the infamous $78 billion market cap destruction scandal of Enron which occurred 15 years earlier in 2001. These scandals appear here to stay as the new normal so these gatekeepers should be doing everything they can to analyze the ongoing fraud problems. Accordingly, as a case study, this paper develops lessons learned from this $86 billion Valeant scandal to emphasize the importance of sustainable corporate governance principles as a pathway to avoid malpractices in the future.

Keywords: Corporate Governance Principles, Sustainability Factors, Board of Director Responsibilities

1. INTRODUCTION

On October 21, 2015 after a Citron Research (2015) report by Andrew Left, a short seller, alleged fraud and compared Valeant to Enron, Valeant's stock plunged as much as 40% or $60 from its opening $150 price. By the end of that day, Valeant's stock price had recovered to close at $118.61 after the company immediately responded to this Citron Research report but Valeant's market capitalization decline on just this one day was $10.8 billion or 26%. On March 31, 2016, Valeant failed to file its 2015 10-K report, an annual report of financial statements to the U.S. Securities and Exchange Commission (SEC), on time which violated its banks' loan covenants. However, these banks (with $30 billion of loans to Valeant) waived the right to call these loans. By April 2017, its stock price was down to $9.02 (with a market cap of $3 billion) from its highest stock price of $257.50 in July, 2015 (with a market cap of $89 billion). Valeant's market cap destruction was $86 billion (a 97% decrease), which exceeded Enron's $78 billion market cap destruction and Enron was ranked the biggest fraud of this century by Forbes (2013). In early 2017, Valeant was selling off $5 billion of its product line assets to reduce its debt to $25 billion (Mattioli, Beneoit, and Rockoff, 2017).

As global stock markets have expanded with more companies and more investors in this century, large market cap destructions have been occurring more frequently, especially facilitated by fraudulent financial statements. In addition to the 2000 Enron $78 billion destruction, $295 billion was destroyed by the 2001 WorldCom, Qwest, and Global Crossing telecom frauds, $60 billion by the 2002 Tyco fraud, $50 billion by the 2003 HealthSouth fraud, $13 billion by the Satyam fraud ("Asia's Enron") and $5 billion by Parmalat ("Europe's Enron") (Grove, 2007-2016). Also, the 2007-2011 initial public offerings (IPOs) and reverse merger frauds of 100 Chinese companies, listing on U.S. stock exchanges, destroyed $40 billion (McKinsey and Company, 2013). The tipping point of the 2008 worldwide recession, the bankruptcy of Lehman Brothers, destroyed $32 billion and the estimated market cap destruction from the entire recession was $1 trillion.

Once again, with these new century frauds destroying well over one trillion of market capitalization and now with Valeant's 2016 market cap destruction of $86 billion, the question must be asked: where were the gatekeepers (boards of directors, regulators, sell-side financial analysts, and auditors) to protect investors? Many of these frauds were caught only by short sellers, such as Jim Chanos (shorting Enron in 2000 and Valeant in 2014), Andrew Left (shorting Valeant in 2015), and buy-side financial analysts, such as Howard Schilit (2010).

This paper has the following major sections: literature review, Valeant's specific corporate governance failures, insider stock sales of Valeant's shares, Valeant's ethical failures, Valeant's legal problems, proactive corporate governance procedures, and conclusion.

2. LITERATURE REVIEW OF THE CORPORATE GOVERNANCE FAILURE AT VALEANT

The failure of corporate governance by Valeant's board of directors was summarized by Richard Davis (2016), a corporate governance and information technology consultant:

"Where were the information and corporate governance checks and balances? Why did it take a report by an activist short seller to reveal this massive alleged fraud? Simply put, had solid information and corporation governance discipline and technologies been in place, a thoughtful outside or independent director would have been able to discover this information long before the Citron Research report and taken action to remediate the resulting governance lapses."

He further argued that proactive corporate governance is much more efficient, as well as capital preserving, than reactive forensic analysis as a discovery function of fraudulent practices. Such forensic analysis has a significantly higher cost and risk of company disruption. Davis concluded that "What happened at Valeant can be described as an epic corporate governance failure" and predicted that subsequent forensic analysis will find that the high integrity management touted in Valeant investor presentations will be shown to have been a sham. "The net result is that an independent board with the requisite resources could have identified and headed off the behaviors that caused this debacle." He advocated for proactive, independent monitoring and analysis of common corporate data sources which would have minimum adverse impact to company operations. Valeant was certainly an example of reactive, not proactive, corporate governance when its board of directors established an Investigative Committee two days after the key Citron Research report came out.

This paper develops key procedures for such independent monitoring and analysis of a company's operations on a proactive corporate governance basis by a company's board of directors, rather than the more costly and disruptive, reactive forensic analysis basis. These procedures rely heavily on the work of various short sellers and financial analysts who blew the whistle on many of the major frauds of the 21st Century, including the Chinese IPO and reverse merger frauds (Chanos, 2014 and 2000; Left, 2015; Block, 2015; Bases et al., 2011; and Schilit, 2010). Such risk assessment screening guidelines and procedures have also been applied to various delisted Chinese IPO and reverse merger companies (Grove et al., 2017).

3. SPECIFIC CORPORATE GOVERNANCE FAILURES AT VALEANT

Major 21st Century frauds have also been analyzed for both financial fraud risk factors and non-financial risk factors, particularly corporate governance weaknesses (Grove and Basilico, 2011). Such non-financial factors of corporate governance weaknesses are analyzed for Valeant. Using a company's DEF14A reports, the proxy statement reports to the SEC, corporate governance can be investigated by using guidance from empirical corporate governance research results, such as the Chief Executive Officer (CEO) duality factor, staggered board elections, and lack of board independence (Allemand et al., 2013; Grove et al., 2011). Such key research variables were found to have a significant, negative impact on risk taking and financial performance as well as possible fraudulent financial reporting. Reviewing Valeant's DEF14A annual proxy reports filed on April 9, 2015 and April 29, 2016, Valeant has the CEO duality problem where the "retiring" CEO, Michael Pearson, was also the Chairman of the Board of Directors (COB) and the new CEO also has both jobs. (There was no mention of the fact that Pearson was actually fired by the board of directors on March 20, 2016.) Furthermore, Pearson had no experience running a business before joining Valeant in 2008.

Concerning staggered board elections where the entire board could not be removed at the same time, Valeant does not have that problem as nine of the eleven directors either retired in 2015 or is retiring in 2016, including the CEO and the head of the Audit Committee. The 2016 board will have 9 of 11 independent directors in accordance with the requirement that U.S. public companies have a majority of independent directors (Rapopart and McNish, 2016). Other empirical corporate governance risk factors are the board diversity problem and the board aging problem, i.e. being "male, pale, and stale." For Valeant, there is only one female on the new board and eight board members will be 60 years or older in 2016 with three in their seventies. Another empirical corporate governance risk factor is the unexpected termination and/or "retirement" of key executives and/or board members, such as Valeant's CEO, Chief Financial Officer (CFO), Audit Committee Chair, and 9 of 11 Valeant's 2015 board members, as well as administrative leave for Valeant's corporate controller.

Another key empirical finding concerning weak corporate governance related to the focus of executive compensation on short-term results (Allemand et al., 2013; Grove et al., 2011). In 2014, the top Valeant executives cashed in heavily on stock options and awards, based primarily on short-term incentive pay targets, well before the October 21, 2015 Citron Research report slammed the stock. These Valeant executives had 2014 compensation from stock options exercised and stock awards in millions as follows: CEO ($19.8), CFO ($23.7), two executive Vice Presidents ($21.4 and $43.1) and the European Manager ($6.3), as compared to average Western Europe CEO total compensation of $3 million to $5 million. Such huge cash outs represent a large red flag by itself, reminiscent of Jim Chanos' comment on the Enron CEO, Jeff Skilling, cashing out and unexpectedly retiring as "a rat leaving a sinking ship!" (Grove et al., 2004). The former Valeant CEO, Michael Pearson, who was fired on March 20, 2016, could still walk away with a severance package of $9 million in cash and stock currently valued at $100 million in May 2016. The former CFO was fired in 2015 but still had total compensation of $606,805. In 2015, the new CFO had total compensation of $60.4 million, including long-term stock awards of $53.1 million (Rapoport and Lublin, 2016).

A research study (Cooper et al., 2013) analyzed executive compensation for the S&P 1500 firms over the 1994-2011 period and concluded: "We find evidence that CEO pay is negatively related to future stock returns for periods up to three years after sorting on pay. For example, firms that pay their CEOs in the top ten percent of excess (incentive) pay earn negative abnormal returns over the next three years of approximately 8%. The effect is stronger for CEOs who receive higher incentive pay relative to their peers. Our results appear to be driven by high-pay induced CEO overconfidence that leads to shareholder wealth losses from activities such as overinvestment and value-destroying mergers and acquisitions." Similarly, the CEOs of collapsed, fraudulent companies gradually slid into the intent to deceive "as hubris consumed them and they did whatever it took to maintain their unique and revered status in the marketplace" (Jennings, 2006). The Greek term hubris describes a personality quality of extreme or foolish pride or dangerous overconfidence. Hubris often indicates a loss of contact with reality and an overestimation of one's own competence, accomplishments or capabilities.

Such overconfidence was displayed by the Valeant CEO, Michael Pearson, who still has $388 million of deferred compensation, mainly common shares vested but not delivered per the Valeant 2015 Proxy Statement. From his former billionaire status, Pearson lost $750 million in the last year and his net worth is now only $175 million (Scott, 2016). A compensation consultant criticized Valeant board members for such stock grants to top executives and said they should have used a more modest and balanced program (Rapoport and Lublin, 2016). Also, Pearson ignored advice from his management team to go slow on price increases on drugs from acquired companies, successfully lobbying for single, sharp price increases. For example, the day Valeant completed a February 10, 2015 purchase of the heart drug, Nitropress, the price was tripled ((McNish and Hoffman, 2016). Such a pricing strategy appears to reinforce a focus upon short-term compensation for both executives and board members as the nine outside board members had total 2014 compensation of $4,134,000 of which $3,572,000 or 86% was in stock awards. The $460,000 average 2014 board compensation for Valeant was almost twice the average U.S. board compensation of $240,000. In summary, overall corporate governance appeared to be weak with several problems indicated by these key research variables concerning corporate governance.

Valeant did acknowledge corporate governance problems when it issued an 8-K report to the SEC on March 21, 2016 in response to revenue recognition and other issues raised in the October 21, 2015 Citron Research report. Valeant concluded that one or more material weaknesses existed in its internal control over financial reporting and disclosures. As a result, such controls and procedures were not effective as of December 31, 2014, as of March 31, 2015, subsequent interim periods in 2015, and, thus, not effective as of December 31, 2015. As part of this assessment, Valeant determined that the "tone at the top" of the organization and the performance-based environment, where challenging targets were set and achieving those targets was a key performance expectation, may have been contributing factors resulting in the Company's improper revenue recognition, i.e., just "make the numbers" for performance rewards. Considering possible executive compensation claw-backs, such deficient internal controls may impact board decisions with respect to 2015 compensation for certain members of senior management (Valeant 8-K Report, 2016).

4. ANOTHER RISK FACTOR: INSIDER STOCK SALES AT VALEANT

Insider stock sales can be another risk factor for corporate governance problems. In response to the problem of insider stock sales during the frauds of the early 2000s, the 2002 U.S. Sarbanes-Oxley Act (SOX) required the prompt reporting of such sales within four days on a Form 4 to the SEC, as opposed to the prior requirement of ten days after the month-end when such insider stock sales were made. One prominent pre-SOX example was Enron where the current and former CEOs, Jeff Skilling and Kenneth Lay, were both selling their own shares while telling investors that Enron's stock was undervalued at $90 and heading toward $120, i.e. the "pump and dump" strategy. In total, Enron insiders sold over $1 billion of their Enron stock just before its collapse in 2001. Financial analysts called such behavior a "screaming" red flag or risk factor for Enron (Grove et al. 2004).

From Valeant's Form 4 reports, the former Valeant CEO, Michael Pearson, sold 1.3 million Valeant shares for $103 million on November 5, 2015, just two weeks after the key Citron Research report came out on October 21, 2015. Four months later on February 18, 2016, the former CFO, Howard Schiller, sold over 54,000 shares for almost $5 million. Four months earlier than this key Citron report, on June 10, 2015 a Valeant board director and hedge fund co-founder, Jeffrey Ubben, sold 4.2 million shares for over $944 million. He has been criticized as a "bad activist" investor who does not have the best interests of investors in mind by focusing upon short-term financial engineering to "make the numbers", rather than substantive plans to improve operating performance. Such "bad activist" investors are likely in the stock for short-term returns with little concern for creating long-term shareholder value (Trainer, 2016), which appears to be a good fit with Valeant's business model and strategy.

On June 2, 2015, four months ahead of this key Citron Research report, the President and General Manager for Europe, Pavel Mirovsky, sold about 38,000 shares for $9 million and he sold another 10,000 shares for $1.3 million on June 2, 2014, sixteen months ahead of the Citron report. On May 4, 2015, five months ahead of this key report, the Executive Vice President, General Counsel and Chief Legal Officer and also formerly the Corporate Secretary, Robert Roswell Chai-Onn, sold about 91,000 shares for over $20 million and he sold another 91,000 shares for over $18 million on March 2, 2015, seven months ahead of this key report. From November 2015 through May 2016, the six months after this key Citron Research report, insider sales were 4.3 million shares, insider purchases were only 30,775 shares, and net institutional sales were just under 13 million shares (finance.yahoo, 2016). Such significant activities for insider and institutional stock sales is a huge risk factor for possible fraud and/or earnings management, especially in relation to the date of the key Citron report.

To emphasize the ongoing nature of this insider stock sale problem, the Equifax Chief Financial Officer and two other senior executives sold almost $2 million of Equifax stock once they learned about the hack of 143 million Americans' credit information at Equifax, well before the hack become public on September 7, 2017 (Cole, 2017). In the following one week from September 7 to September 13, the Equifax stock fell from $142.72 to $97.50 or $45.22, a 32% drop. Over twenty-five lawsuits have subsequently been filed against Equifax.

5. RELATED ETHICAL FAILURES AT VALEANT

Related non-financial risk factors concerning ethical problems are analyzed for Valeant. A key procedure is an investigation of a company's ethical practices. The U.S. Senate Special Committee on Aging has been investigating companies that raised prices on old drugs to exorbitant levels and had a hearing on April 27, 2016. The terminated Valeant CEO, Michael Pearson, conceded mistakes on favoring profits over patients' needs and said: "I regret pursuing transactions where a central premise was a planned increase in the prices of medicines." One Senator commented that the company's policy was "using patients as hostages. It's immoral. It hurt real people" (Thomas, 2016). Per the October 2, 2015 Citron Research report, Valeant's cumulative price increases as of February 10, 2015 for the heart drugs, Isuprel and Nitropress, were 525% and 212%, respectively. They were the two biggest contributors to EBITDA in the first quarter of 2015 per internal Valeant emails revealed by an investigation of the U.S. House Oversight Committee (Grant, 2016). Also, concerning ethics, the former CFO has accused of improper conduct by Valeant.

Valeant is facing multiple federal investigations for its practice of buying companies, slashing costs by firing employees of those companies, and raising prices, as well as its relationship to the mail-order pharmacy, Philidor. Valeant has since cut ties with Philidor, another red flag, which seems to confirm the negative Citron report concerning Valeant's relationship with Philidor. At this Senate Committee hearing, a doctor testified about a Wilson's disease medication that has been available for 50 years and costs just $100 in Europe but now over $300,000 per year in the U.S. after Valeant acquired the drug company and raised the price of this drug: "We're not just talking about costs here. Some patients who do not get these drugs can die. We're talking about human lives if they don't get access to the drugs." Another doctor testified that a liver transplant, an alternative treatment for Wilson's disease, is now cheaper that a lifetime of Valeant drugs (McNish and Hoffman, 2016).

At this Senate Committee hearing, another one Senator commented: "These enormous and unwarranted price hikes have had far-ranging and severe impacts on patients, hospitals, and our health care system. Valeant's monopoly model operates at the expense of real people." Valeant's new CEO then pledged to offer hospitals price breaks up to 30% on Isuprel and Nitropress, two of its expensive heart drugs, though large U.S. group purchasing organizations, Ascension, Premier, and MedAssets, which negotiate prices on behalf of hospitals. However, three weeks after this Senate Committee hearing, only two of Premier's 2,500 member hospitals had received these 30% discounts and a Premier spokeswoman said "the percentage of hospitals getting the discount was so low because it only applies to very high volume purchases." Furthermore, the Mayo Clinic, the Cleveland Clinic and New York-Presbyterian, all top-ranked heart hospitals, do not qualify for the discounts because they do not use any group purchasing organizations. One hospital chief pharmacy officer commented: "they raised the price 800% and they are going to give 30%? It is still not enough, compared to the egregious price increases they have done" (Thomas, 2016). A venture capitalist observed: "Jacking up prices of old drugs with no R&D risk-taking is just not right" (Pollack and Tavernise, 2015).

Since the U.S. is the only developed country without some form of control over drug pricing, the U.S. has the highest drug prices in the world (Left, 2015). The only hope to check such unrestrained drug price increases may be the Valeant class action lawsuit, not any new U.S. laws. Unfortunately, there continues to be a "do-nothing" U.S. Congress, especially since these elected officials often spend four hours a day telemarketing for campaign contributions per a 60 Minutes investigative report aired in April 2016.

As an ethical guideline, Andrew Left of Citron Research (2015) had this advice: "When the CEO sounds desperate and begins to lie, it is time to exit the stock." He cited the former Valeant CEO Pearson's letter to employees addressing their concerns about Valeant's stock price. The CEO stated that Valeant was not dependent upon drug price increases and that Valeant had strong organic growth. Further advice from Citron: "It is Citron's strong opinion that Pearson's hyper-sensitivity to his company' stock price is typical of CEOs with something to hide. The last time we saw a CEO make a public comment of this magnitude about his company's stock to his employees was Kenneth Lay." Lay made a similar statement after he returned as Enron's CEO, following the unexpected resignation of the former Enron CEO, Jeff Skilling. Both Skilling and Pearson came from the consulting firm, McKinsey & Company, without any CEO experience.

6. RELATED LEGAL PROBLEMS AT VALEANT

Related legal problems from these corporate governance and ethical problems are analyzed. One procedure is reading a company's legal proceedings footnote in its 10-K report. Valeant's legal footnote began with the customary cautionary tones: "From time to time, the Company becomes involved in various legal and administrative proceedings, which include product liability, intellectual property, commercial, antitrust, governmental and regulatory investigations, related private litigation and ordinary course employment-related issues. From time to time, the Company also initiates actions or files counterclaims. The Company could be subject to counterclaims or other suits in response to actions it may initiate. The Company believes that the prosecution of these actions and counterclaims is important to preserve and protect the Company, its reputation and its assets. Unless otherwise indicated, the Company cannot reasonably predict the outcome of these legal proceedings, nor can it estimate the amount of loss, or range of loss, if any, that may result from these proceedings. An adverse outcome in certain of these proceedings could have a material adverse effect on the Company's business, financial condition and results of operations, and could cause the market value of its common shares to decline."

A review of Valeant's 2014 legal proceedings footnote of nine pages revealed litigations in 24 investigations and lawsuits, only one of which has been settled. So many lawsuits indicate a risk factor for the company's business operations. There were government and regulatory investigations for a Massachusetts anti-kickback statue, a U.S. Federal trade Commission patent infringement with a generic drug manufacturer, a U.S. Department of Health and Human Services questionable drug payments with medical professionals, and a U.S. Department of Justice civil and criminal agreement which required a Valeant affiliate to create a compliance and ethics program for three years. Also, there were five securities class action lawsuits, one antitrust lawsuit, eleven intellectual property lawsuits, including brand names versus generics and patent infringement cases, one general civil action for misrepresenting cold medicine benefits, one employment lawsuit involving female gender discrimination, and one product liability lawsuit for personal injury from using content lens solutions.

On October 23, 2015, two days after the key Citron Research report came out, a class action complaint for violations of the Federal Securities Laws was filed on behalf of Valeant shareholders. According to the law firm press release, the lawsuit alleges that the defendants, Valeant, the former CEO, and both CFOs, issued materially false and misleading statements to investors and/or failed to disclose ten key items, such as deficient internal controls, a relationship with a network of specialty pharmacies used to boost Valeant's sales of its high-priced drugs and related financial performance, and Valeant's true relationship in controlling Philidor. The lawsuit further charged that defendants were engaged in a scheme to manipulate Valeant's stock price and, as a result, Valeant's public statements were materially false and misleading and/or lacked a reasonable basis at all relevant times. The entire key October 21, 2015 Citron Research Report was included in the class action complaint. No amount for damages was provided, just "compensatory damages for all damages sustained as a result of defendants' wrongdoing in an amount to be proven at trial, including interest thereon" (Stanford, 2015).

In its 2015 10-K, Valeant disclosed new investigations by state regulators in North Carolina for drug pricing and in New Jersey for the Philidor relationship. Federal prosecutors in New York and Massachusetts were already investigating Valeant for drug pricing and are now also investigating the Philidor relationship. One U.S. Senate and one U.S. House of Representatives Congressional committees are also investigating these issues (Rapoport and McNish, 2016).

7. PROACTIVE CORPORATE GOVERNANCE PROCEDURES APPLIED TO VALEANT

To help with identifying bad behavior, Jim Chanos, the billionaire short seller, recommended a "wonderful" checklist, the Seven Signs of Ethical Collapse in an organization (Parramore, 2013). These seven signs are: pressure to maintain numbers, fear of silence, young 'uns and a bigger-than-life CEO, weak board, conflicts, innovation like no other, and goodness in some areas atoning for evil in others (Jennings, 2006). The recommended proactive procedures here do consider most of these seven signs and frequently rely on SEC reports as a starting point. Also, Andrew Left, another short seller, has warned analysts, as well as board members, to investigate their concerns without starting with the phrase: "after discussions with management" in an attempt to improve the quality of evidence and analysis (Left, 2011).

Key proactive corporate governance procedures for boards of directors are summarized and applied to Valeant Pharmaceuticals. Ten major procedures indicated fraud risks for Valeant as follows in order of recommended investigations by boards of directors:

1.Revenue disclosure footnote analysis in 2014 and 2015 10-K reports revealed that Valeant used distributors which are a high risk for channel stuffing to increase revenues with possible misleading financial statements. On March 21, 2016 in Valeant's 8-K report, such stuffing was admitted which reduced 2014 revenues by 1% and net income by 4% in the restated financial statements.

2.Revenue and customer investigations for Valeant's distributors by Citron Research uncovered possible phony revenues from questionable distribution networks, as admitted in the above 8-K report. Citron's online investigations were an extension of traditional onsite audit investigations of physical assets started in 1937. The major distribution network, Philidor, has since been terminated and Philidor itself closed.

3.Competitive analysis revealed the predatory drug pricing policy of Valeant which is now being investigated by two Congressional committees as well as other regulatory agencies.

4.In 2014 and 2015 8-K reports, the non-GAAP reporting strategy of Valeant helped reveal its earnings management strategy which was also used for executive compensation. This non-GAAP analysis can be guided by Deloitte & Touche's ten question approach, PriceWaterhouseCooper's five step approach, and the SEC's four examples of guidance for assessing misleading non-GAAP metrics. Valeant appeared to have problems with all 19 of these guidelines.

5. An analysis of SEC comment letters issued for Valeant revealed ongoing revenue recognition and disclosure problems as far back as at least 2012.

6. On recent Form 4 reports to the SEC, an examination of insider trading in the six months from November 2015 through April 2016 revealed that both executives and institutions selling shares (net of minor purchases) of 4.3 million and 13.0 million, respectively.

7. An examination of the Valeant DEF14A proxy statement reports to the SEC revealed many key corporate governance weaknesses, such as the CEO duality problem, unexpected terminations and resignations of top executives and board members, lack of board diversity, a majority of older directors, and focus on short-term incentive compensation for both top executives and board members. Valeant's 8-K report on March 21, 2016 did acknowledge corporate governance problems, primarily the "tone at the top" and the short-term performance-based compensation focus contributing to the channel stuffing problems.

8. A reading of Valeant's legal footnote disclosures in its 2014 and 2015 10-K reports revealed 24 ongoing investigations and lawsuits, the most recent being a shareholder class action lawsuit filed two days after the key Citron Research report came out on October 21, 2015.

9. A reading of the 2016 U.S. Senate and the U.S. House of Representatives Congressional hearings investigating Valeant revealed more unethical practices concerning Valeant's predatory drug pricing policy.

10. Additional follow-up procedures included the comparisons of Valeant's reporting to different government entities, which revealed a significant difference in income tax rates: 16% in its 10-K financial reports versus 9% in its tax reports. Both rates were very low as Valeant was the first U.S. pharmaceutical company to do the tax inversion strategy by relocating to Canada. Another follow-up procedure found increasing credit default swap spreads on Valeant's debt of $31 billion, which implied a 43% probability of default on such debt.

8. CONCLUSION

Citron Research's final Valeant report on November 3, 2015 concluded that Valeant was un-investible for the foreseeable future and raised eleven immediate concerns facing Valeant management, its board of directors, and its shareholders as follows:

1. Valeant's civil and criminal culpability for the actions of the Philidor Network, stretching back to its creation. Possibilities are insurance fraud, mail fraud, accounting fraud, Health Insurance Portability and Accountability U.S. 1996 Act (HIPAA) violations of patient health records privacy, perjury in state regulatory filings, and civil and criminal issues under the Racketeer Influenced and Corrupt Organization U.S. 1970 Act (RICO).

2. The harsh financial consequences of cancer prescriptions improperly reimbursed through now cancelled Pharmaceutical Management Branch (PMB) contracts.

3. Loss of at least half, and possibly all, of Valeant's Dermatology drug channel.

4. Heightened scrutiny from auditors that will extend through all Valeant's distribution channels, including the entire "consolidated" Philidor network, as well as Europe.

5. Earnings restatements - How can these possibly be avoided, given the volume of manipulated prescriptions?

6. Responding to dozens of subpoenas and whatever charges come from the investigations.

7. The end of Valeant's drug price increase strategy.

8. The end of Valeant's acquisition strategy.

9. Eroding revenue base across nearly all product lines due to reputational damage. All drugs are melting "ice cubes" due to improved treatments, generic competition, and aging patents. All this reputational damage simply accelerates the rate at which Valeant's "ice cubes" melt.

10. Vulnerability to unfavorable tax treatment rulings from the U.S. as well as Canadian tax authorities, which are conducting reviews of several years of Valeant's past returns as well as going forward.

11. Dramatically increasing credit default swap spreads on Valeant's debt which implies a 43% probability of default. Will Valeant be able to generate sufficient cash to serve its $31 billion debt load resulting from its pharma company leveraged acquisition strategy?

All eleven of these concerns can be related to, and reinforce, the deficiencies and failures of corporate governance by Valeant's board of directors. This entire paper can be used for lessons learned from such corporate governance failures which have resulted in $86 billion market value destruction for investors. Enron, Forbes's number one fraud of this century, had a similar $78 billion market cap destruction and similar corporate governance failures, as pointed out by the 2015 Citron Research report, which labelled Valeant as the "Pharmaceutical Enron". How many times must lessons to be learned be relearned, as in these similar year 2000 and year 2016 corporate failures?

A good starting point to correct such failures and market cap destructions would be for any board of directors to use these ten recommended investigatory procedures here for sustainable or proactive, rather than reactive, corporate governance. The sustainability of corporate governance principles would be enhanced. A corporate governance consultant concluded: "Simply put, had solid information and corporate governance discipline and technologies been in place, a thoughtful outside or independent director would have been able to discover this information long before the 2015 Citron Research report and taken action to remediate the resulting governance lapses" (Davis, 2016).

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