### PharmCo, Inc.

<table>
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<tr>
<th>Listing: NASDAQ</th>
<th>2013 Sales: $275 million</th>
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<td>Headquartered: Massachusetts</td>
<td>2013 EPS: $1.35</td>
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<tr>
<td>Incorporated: Delaware</td>
<td>Worldwide Employees: 500</td>
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**About PharmCo:**

- Nearly all revenue comes from sales of LoMot, which has been a commercial success since its launch in 2011.
- LoMot is the leading long-term treatment for patients who suffer from motion sickness, chronic nausea or vertigo. LoMot is not approved for any other use.
- LoMot’s most common side effect is a marked loss of appetite.
- LoMot’s proven success has made it frequently prescribed for patients enrolled in the federal Medicare and state Medicaid programs.

**Organization Chart:**

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Chairman of the Board
Fred Founder

Lead Independent Director and Audit Committee Chair
P.E. Vistor

Chief Executive Officer
Sam Incharge

Vice President of Sales
Victor Veepee

Chief Financial Officer
Lauren Dollar

Chief Science Officer
Dr. Nye

Vice President of Manufacturing
Joe Mills

General Counsel
Janet Inhouse

Sales Manager
Lorraine Lacey

Sales Manager
Daryl Dunno

Sales Manager
Wendy Day

Head of Compliance
Chris Compliance
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A. The Hotline Call

On September 15, 2013, an anonymous female caller leaves a message on PharmCo’s compliance hotline stating that the Vice President of Sales, Victor Veepee, instructed his team to “pitch the weight-loss benefits” of LoMot, and has told anyone who pushed back “to find another job.”

Pursuant to PharmCo policy, Chris Compliance in the Compliance Department promptly forwards the message to GC Janet Inhouse. Inhouse and Compliance agree that the call requires follow-up. In accordance with policy, Inhouse informs Incharge and Audit Committee Chair P.E. Vestor about the hotline call and their plans to conduct a preliminary inquiry. During their conversation, Incharge tells Inhouse to be reasonable in the scope of the inquiry. Incharge suggests they interview Veepee and his direct reports.

A week later, Compliance reports that during brief telephone interviews he conducted:

- Lorraine Lacey, one of the three sales managers, firmly stated that Veepee never gave any instructions to promote LoMot for weight loss. She added that any such instructions would be strictly “against company policy.”

- Daryl Dunno, another of the sales managers, said he did not recall “any employee” at PharmCo ever telling him to promote LoMot as a weight loss drug.

- Compliance noted that he was unable to interview Wendy Day, the third sales manager listed in the company’s org chart, because Day was no longer with the company. According to personnel records, Day was recently terminated for “poor performance.” Lacey and Dunno both had negative things to say about Day. In particular, Lacey offered a long list of reasons why Day was not a good employee.

- Veepee categorically denied ever instructing his team to market LoMot as a diet drug. He said that the false allegations probably came from Day, adding “I never should have hired Day. She was a constant source of problems and her sales were always the weakest.”

- Veepee and Lacey volunteered to provide copies of training materials they had developed years ago to avoid potential problems that could result from off-label marketing.

Inhouse prepares a “Privileged Memorandum to File,” dated October 1, 2013, documenting the response to the hotline message, including a summary of the facts learned and the joint conclusion of Inhouse and Compliance that “there appears to be no factual basis to support the anonymous allegation” and that no further action is necessary. She advises Incharge and Audit Committee Chair P.E. Vestor of their conclusion.

Discussion Questions

1. What factors should a company consider when deciding whether to investigate?
2. Was the “preliminary inquiry” an appropriate response?
3. What, if any, further steps should PharmCo have taken?
4. Should the company have placed Veepee on leave during the investigation?
5. Who else, if anyone, should be informed of the preliminary inquiry? Chairman of the Board? The full Board? The auditors?
B. The Civil Investigative Demand

On December 15, 2013, the U.S. Attorney’s Office for the District of Arizona serves a civil investigative demand (“CID”) for documents on Pharmco. It requires production, among other things, of all data from January 1, 2011 to the present concerning PharmCo’s:

1. Marketing and sales of LoMot nationwide
2. Communications and relationship with Dr. Larry Scales
3. Communications with the Food and Drug Administration concerning LoMot.

Inhouse immediately calls the Assistant U.S. Attorney, Peter Prosecutor, to pledge the Company’s “full cooperation.” Prosecutor says he expects to receive “a lot of documents, including emails and text messages.” Inhouse advises Incharge and Pharmco’s Board of Directors of the CID’s receipt.

A Google search by Inhouse reveals that Dr. Scales is a general practitioner in Phoenix, Arizona, who also runs several weight loss and nutrition clinics across the country. When Inhouse looks up Scales in PharmCo’s marketing database, she learns that during 2011 and 2012, he delivered 8 lectures on LoMot to prescribing physicians and received a $12,000 honorarium for each. It also appears that the company reimbursed him for some travel expenses.

Inhouse meets with Incharge and tells him that the legal department does not have the internal resources to respond to the CID. She also informs Incharge about what she learned regarding Scales. Incharge appears alarmed and is reluctant to hire outside counsel. He believes hiring outside counsel will disrupt PharmCo’s business, cause fear within the company, and result in leaks to the media and substantial costs. Incharge tells Inhouse that he will consider the matter further.

Discussion Questions

6. What should PharmCo do now?
7. What steps should PharmCo take to preserve potentially responsive data?
8. Should PharmCo publicly disclose its receipt of the CID? How should it decide?
9. Should PharmCo hire outside counsel?
C. The Internal Investigation

Incharge agrees that Inhouse can engage outside counsel to help with the mechanics of responding to the CID. PharmCo retains Vera Wise of Wise & Worth LLP. Wise advises Inhouse to distribute broadly a document preservation notice and begins to interview sales employees.

- Veepee informs Inhouse that he will not appear for his interview unless Pharmco: (i) permits his attorney to attend; (ii) advances his attorney’s fees under the company’s indemnification policy; and (iii) agrees to conduct his interview pursuant to a joint defense agreement. In a separate conversation, Veepee tells Incharge, “We are all in this together and I need counsel watching my back, just as you need counsel watching yours.”

- Incharge tells Inhouse that PharmCo should advance all legal fees for the senior management because it is the “right thing to do.”

- Dunno agrees to be interviewed without counsel. He states that he had heard of the lectures by Scales and thought they were really interesting and helping the company. When asked why he didn’t mention the lectures during the prior inquiry, Dunno says that Compliance only asked about Veepee and Dunno didn’t think Scales was relevant.

- Inhouse also learns informally that the U.S. Attorney has served a CID for the sworn testimony of Veepee on February 15, 2014.

- Incharge is beginning to think that PharmCo must “get out ahead” of rumors about the CID, which are starting to pop up among industry players, by making a detailed public statement. He believes the “short and oblique” press releases issued by other drug companies in tough situations say so little that they probably just exacerbated investor and patient fear.

- PharmCo’s auditors ask the senior management team for the results of its internal investigation in connection with its work to finalize the company’s upcoming 10-K filing.

Discussion Questions

10. How should PharmCo respond to Veepee’s requests?
11. What issues are presented by Incharge’s conversation with Inhouse about providing separate counsel?
12. What, if any, action should PharmCo’s Board take now?
13. How should PharmCo respond to its auditors?
14. Should Incharge make any public statements? If so, what should he say?

During the document collection process, Inhouse notices that Incharge and Lacey exchanged more than 15,000 text messages on company-issued phones during the CID period. Although none of the text messages was flagged as part of the key word searches the company used to identify potentially relevant documents, Inhouse decides to review some of the messages. Inhouse determines that the messages reveal an ongoing personal relationship between Incharge, who is married, and Lacey, his subordinate. Any such relationship would be inconsistent with Company policy.

15. What actions should PharmCo now take in regard to the text messages? How might the text messages affect the larger investigation?
D. **Parallel Problems**

The last two weeks have been busy:

- **State Attorney General.** The Attorney General’s Office of Arizona sends a letter to PharmCo announcing that it has opened an investigation into the conduct of PharmCo and Dr. Scales “with regard to” the Arizona Medicaid program. A subpoena calling for several broad categories of documents is enclosed.

- **Qui Tam Complaint.** Inhouse receives a recently-unsealed *qui tam* complaint filed under federal and state false claims statutes by former sales manager Wendy Day that alleges off-label marketing of LoMot and unlawful kickbacks to Scales.

- **The Press.** Reuters reports the filing of the *qui tam* complaint and that, according to unnamed sources, the Arizona AG has taken the “initial step in a criminal fraud investigation that may also involve federal authorities.” PharmCo’s stock price drops almost immediately. The *Wall Street Journal* calls PharmCo for comments on a recent analyst report that concludes, “this is part of a pattern of bad conduct at PharmCo, and there will be other shoes to drop.” PharmCo knows this analyst is heavily influenced by short sellers.

- **Shareholder Class Action.** A shareholder class action lawsuit is filed alleging that PharmCo inflated its stock price during the past 18 months by “a Company-wide fraud to promote LoMot as a weight-loss drug,” and that PharmCo sought to “muffle” questions about the integrity of its marketing practices. Plaintiffs’ private investigators have been calling employees to get their “perspective” and to enlist any assistance they can provide to help investors bring “the truth to the Court’s attention.”

- **Fifth Amendment.** Veepee, through his Company-paid attorney, has advised the Company that Veepee is thinking about asserting his Fifth Amendment privilege.

**Discussion Questions**

16. What should PharmCo’s Board do now? How should it respond to each of these developments?

17. What, if anything, can PharmCo do to coordinate its response to Arizona’s AG with the work already being done to respond to the U.S. Attorney?

18. What can it do to minimize the disruption to PharmCo’s business, and the expense of addressing these parallel problems?

19. How should the Company respond to the possibility of Veepee asserting his Fifth Amendment privilege?