

Why general counsels don't stop corporate crime

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General counsels for corporations are well-versed in the law and should be able to detect and stop fraud, not profit from stock sales utilizing their fraud-related insider information.

Researchers from the University of Michigan zeroed in on the potential reasons that corporate counsels are failing to report and prevent corporate crime.

The Sarbanes-Oxley Act of 2002 was an answer to rampant corporate [fraud](#) involving companies such as Enron, Worldcom and Tyco. The act required corporate attorneys to report any suspicion of violation to top executives and board of directors.

"More than any other executives in the corporation, corporate attorneys are expected to understand potential violations of law," said Nejat Seyhun, finance professor at U-M's Ross School of Business. "They are expected to use their legal expertise to advise, intervene and stop wrongdoing."

Seyhun and S. Burcu Avci, a research scholar, analyzed insider trading activities of top executives, general counsels and other officials listed in Securities Class Action database. Looking at cases filed in federal court from 1996-2014, they compared those with [insider trading](#) data and found that general counsels were more aggressive sellers of company stock than other executives.

General counsels increased their sales of stock during the class action period by 63 percent, which indicates that they were aware of the overvaluation of their common stock due to the fraud and were acting proactively to reduce their potential losses by reducing their holdings.

The fraudulent activity costs shareholders billions. The average class action settles for \$170 million, they found. Given this, the estimated range of damages caused by the alleged fraud is between \$6 billion and \$30 billion.

"Our evidence shows that general counsels are part of the fraudulent group," Seyhun said. "They are heavy sellers of their own firm's stocks and profit abnormally by avoiding the [stock](#) price declines upon revelation of the fraud at the end of the [class action](#) period."

More information: Sureyya Burcu Avci et al. Why Don't General Counsels Stop Corporate Crime?, *SSRN Electronic Journal* (2016). [DOI: 10.2139/ssrn.2804352](https://doi.org/10.2139/ssrn.2804352)

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