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EDITORIAL

Theranos's Fraud Tested the Limits of the Disruption Tale

By The Editorial Board

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Dozens of biotechnology start-ups across the country are investing in the research and development that Big Pharma has stopped funding. Clementia, for instance, is zeroing in on rare bone diseases. Catabasis Pharmaceuticals is focused on amyotrophic lateral sclerosis and other terrible neurological conditions. Quanterix and others are developing blood-based diagnostic tests to help doctors offer more targeted cancer treatments, for example.

The pipelines and progress of these companies are visible, and their clinical trial results knowable, since they conform to Food and Drug Administration protocols as well as Securities and Exchange Commission investor regulations, in the case of publicly held companies.

Theranos, a company that claimed to have reinvented blood testing, and thus a big swath of medicine itself, conformed to none of this. Its founder, the far-too-famous Elizabeth Holmes, controlled the voting stock, the board of directors and the corporate messaging to execute one of the most outrageous acts of corporate prestidigitation since Enron convinced us that it had reinvented energy. Enron was so good at it that even Newton might have been an investor.

Claiming it had come up with a portable analyzer that could perform a full range of tests with only a pinprick of blood, Theranos cast a medical spell over sophisticated investors, the public and the media. But on Wednesday, the company settled fraud charges leveled by the S.E.C. against Ms. Holmes; the former Theranos president Ramesh Balwani has also been charged but will go to trial.

The agency accused Ms. Holmes and the company of raising $700 million from investors by faking data, orchestrating tests and simply lying to investors and the media to cover up that they had no device that actually worked and were mainly using outside laboratories to assess blood samples.

Ms. Holmes, who did not admit or deny wrongdoing, will pay a $500,000 fine, which seems trivial given that the company was once valued at $9 billion, purportedly making her Silicon Valley's first self-made female billionaire. She's also barred from serving as an officer or director at any public company for 10 years, and she's returning 18.9 million shares. The penalties are small for such chicanery, but federal prosecutors are still conducting a criminal investigation.

We shouldn't be surprised by any biotech's failure. We should expect it. Biotechs by their nature offer the promise of disruptive breakthroughs and discoveries, but they're mostly all-in propositions, based on one molecule or one test. Fail in a Phase III clinical trial — and a majority do — and you're finished. It's a moonshot business; companies are going to blow up.

Start-ups blow up in Silicon Valley all the time, too, but what's surprising is how long Ms. Holmes could peddle her disruption tale before regulators stepped in. The story was just too good to resist — a brainy 19-year-old drops out of Stanford and creates a device that can make blood testing vastly easier and more accessible. Her investors included Valley powerhouses such as Draper Fisher Jurvetson, health care players such as Walgreens and BlueCross BlueShield Venture Partners, the media tycoon Rupert Murdoch and Tako Ventures, founded by Oracle's Larry Ellison. She also assembled a brand-name board that included at one time or another two former secretaries of state, George Shultz and Henry Kissinger; former Senator Bill Frist (a physician); and the superlawyer David Boies, whose firm was involved in efforts to quiet a company whistle-blower and who reportedly tried to get The Wall Street Journal to kill an article that uncovered the fraud.

In 2013, Ms. Holmes added another heavyweight to the board, Jim Mattis, the general in charge of the United States Central Command. While in that command, Mr. Mattis, too, caught the Theranos fever and pushed to have the company's tests used in the field. Ms. Holmes had pushed the military story line even harder, telling Walgreens, which thought it was using its tests, that its analyzer was already aboard military helicopters. That was false. The Department of Defense is a regular investor in tech start-ups and like any venture capitalist is willing to suffer investment losses. But Theranos got red-flagged at some point by the F.D.A. and defense officials. Mr. Mattis would get green-flagged to a better gig after his time on the Theranos board: secretary of defense.

Theranos's gullible investors acceded to Ms. Holmes's demand for supervoting stock and were willing to believe whatever she was selling, even as her story began to unwind.

"I think the board has complete confidence in Elizabeth Holmes as a founder of the company, as a scientist and as an administrator," Mr. Boies told The Times's Reed Abelson in April 2016, a few months after the Wall Street Journal article that Mr. Boies reportedly tried to have killed cast serious doubt on Theranos's technology and execution.

It’s possible that the finger-prick blood analyzer Ms. Holmes envisioned will someday make it to market. But Theranos shows us once again that when a start-up promises disruption, you are just as likely to get stuck.

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