

## Project: *Corporate Counsel – Law Firms*

# Vital Role Of Criminal Defense Counsel In The New Legal Environment

The Editor interviews **John P. Lacey**, Partner, Connell Foley LLP. Mr. Lacey served as an Assistant United States Attorney for New Jersey, handling a large variety of successful high profile criminal prosecutions, asset forfeitures, as well as numerous successful appeals before the United States Court of Appeals for the Third Circuit. Mr. Lacey, who joined Connell Foley LLP in 1991, concentrates his practice in federal litigation, complex commercial matters, employment law, white-collar criminal defense and internal and external corporate and government investigations.



**John P. Lacey**

**Editor: What are your thoughts about the *Scrushy* case?**

**Lacey:** It is another example of a superstar CEO being the focus of prosecutorial attention. Even looking at the facts in the best light, there were a number of misjudgments by Mr. *Scrushy*, and various other officers already have admitted wrongdoing. My guess is that he has put up a vigorous defense because the case against him involved a number of significant charges that could require him to spend considerable time in jail. The money laundering charges were extensive and the alleged fraud involved over \$2 billion dollars, which would require a very severe jail sentence under the Federal Sentencing Guidelines.

**Editor: What does the *Scrushy* case have in common with other corporate scandals?**

**Lacey:** In all of these cases we find a number of common elements. First, there is a CEO, and often a group of other senior executives, who have very large egos and strong personalities. Rather than use a team approach to collecting and evaluating information, these executives will dictate that their subordinates achieve financial and other goals that appear completely unrealistic. The subordinates will then either use illegal methods to obtain those results, or they will fall short of the goals but will falsely assert that the goals were achieved by reporting inflated financial results. In some cases, the executives will specifically direct that false information be reported, but more often it is a subtle suggestion by the senior executive to rationalize the false report as being insignificant.

Second, the directors, who are charged with overseeing the company's overall operations periodically, and other executives will be reluctant to challenge the CEO's authority or to impugn his character by accusing him of "fudging" on the financial statements. This failure to challenge the numbers will thus embolden the senior executives to inflate their numbers by even greater amounts in the future. In the rare case where the senior executives' actions are challenged, the CEO will take offense and the directors will back down on their demands.

In sum, the danger is created where any senior executive is allowed to insulate himself in a way that not only prevents his actions from being carefully

scrutinized by the Board and by auditors, but also permits him to deny responsibility for the actions of subordinates. In this way, the senior executives will keep important information to themselves and away from those that might question their actions. This allows them to maintain control of the situation at all times.

**Editor: What should the role of in-house counsel be where there are compliance breakdowns?**

**Lacey:** Sarbanes-Oxley puts corporate counsel in the direct line of fire. They have a responsibility to let the CEO and Board know if the company lacks a legal compliance system that reflects best practices for companies of that size and to hire experienced counsel to help implement such a system. This is especially important because it is likely that the general counsel will be held responsible for compliance failures that could have been avoided if such a program had been in place. If there are tough issues to be raised with senior executives (including the CEO) or the Board, he or she has a responsibility to raise them even if that may mean the end of his or her employment.

Where a major scandal is uncovered, the general counsel is likely to lose credibility with the Board in any event because the scandal occurred on her watch. This means that the Board must bring in its own independent legal team. In the course of this interview, I will suggest reasons why white collar criminal defense counsel is an essential part of that team.

**Editor: What about the role of the prosecutor today. Do they wield too much power?**

**Lacey:** In virtually every case, the government is using the hammer of the Federal Corporate Sentencing Guidelines to force corporate targets to waive their attorney/client privilege and to have officers and directors cooperate with them. They can elicit testimony by giving immunity to employees who cooperate with the government.

The Federal Corporate Sentencing Guidelines open the door for the federal government to obtain draconian sentences. Conviction could potentially shut the corporation down. Organizations in

some industries are particularly vulnerable. For example, government contractors can lose their ability to sell to the government and those companies in regulated industries can be stripped of their ability to continue in business – as in the Arthur Andersen situation. That could mean billions of dollars in losses or the destruction of the company in its entirety.

**Editor: What can companies involved in these kinds of situations do to mitigate the effect on the company?**

**Lacey:** Tyco is an example of how a corporation can emerge from the effects of a scandal. Its stock price plummeted over a period of many months. Ultimately its recovery was due in part to getting good advice. The Tyco Board put in place a mechanism that was designed to investigate and root out any corruption within the corporation and to correct any errors made in the past. The CEO who was allegedly involved in the wrongdoing was removed as a result of Board action. Now we are seeing the fruits of those efforts reflected in the enormous turnaround in the stock price.

Establishing a cooperative relationship with prosecutors from the very start also is essential, but it must be done through an attorney experienced in these matters because there are any number of missteps that may occur along the way and they have to be avoided at all cost. This is best done by retaining a white collar criminal defense lawyer who has a record of being able to establish good working relationships with prosecutors. It is essential that the prosecutors feel confident that the company will cooperate fully with them in prosecuting the wrongdoers. If there is any indecisiveness at the Board level, prosecutors will tend to view such action as a potential obstruction of justice and may pursue charges against the corporation and its directors.

**Editor: If it becomes evident that the company may be the target of serious criminal charges, how should the Board proceed?**

**Lacey:** The first step is for the Board to meet with an experienced white collar criminal defense lawyer after that lawyer has had an opportunity to become informed about the ongoing investigation and gotten some hints from the government about the substance of the claims being made. The first conversation with the Board is usually very difficult. When I have met with Boards in that situation, there is usually a lot of finger pointing and animosity – including against the criminal defense attorney for bringing bad news to the corporation. The prosecutor expects immediate and responsible action by the Board. The boards I have dealt with have acted very responsibly, even if there was some reluctance at the beginning to take my advice. In every case, I was able to convince the prosecutor either that the allegations against the corporation were groundless or that the corporation was eager to work with the prosecutors to root out the wrongdoers, to set up adequate compliance programs and to see that the wrongdoers were brought to justice. In the end, the government

looked favorably at each corporation and its Board.

**Editor: Given their potential exposure, should individuals become directors?**

**Lacey:** I believe that there is little likelihood of personal liability (whether civil or criminal) if the director has no conflicts, acts in good faith, does her homework and takes care to see that the Board minutes reflect the processes followed by the Board in connection with the approval of significant transactions. If individuals are invited to serve as directors of public companies, they should also assure themselves that the corporation has a majority of independent directors who meet from time to time without members of management being present, has an effective audit committee, has a compliance oriented "tone at the top," has internal control and compliance systems that meet the standards of Sarbanes-Oxley and the Federal Corporate Sentencing Guidelines, and has a competent general counsel with the staff and tools to do her job and who meets periodically with the independent directors or the audit committee without other members of management being present.

A potential director should assure himself that company indemnification and D&O coverage is in place, but should also recognize that there are weaknesses in both of these protections (both as to adequacy and exceptions). Because of these weaknesses total reliance cannot be placed on them. Therefore it is imperative that the potential director be sure that the corporation and the directors follow the practices mentioned above. If this is done, they will also be protected by the "business judgment" rule. Prosecutors are looking to prosecute intentional wrongdoing, not directors who use their informed business judgment.

**Editor: Do directors come to you who are uncomfortable about the degree of protection they have in the event of a scandal?**

**Lacey:** Normally I will represent them as a Board. However, some Board members have retained me as their individual counsel.

Right now some high level executives are hesitant to sign the Sarbanes-Oxley certification regarding the accuracy of the financial records until they take a closer look. This is one reason why some earnings reports are delayed. Boards and officers are obviously very concerned and look to counsel for comfort. Many corporate counsel seek outside advice about how to handle directors' and officers' questions about the adequacy of internal controls. They wish to take advantage of outside counsels' knowledge of the best practices being followed by other companies. We have been asked by a number of our clients to make sure that controls are in place to prevent the types of things that led to the scandals. When these types of proactive measures are taken, corporate officers, including the general counsel, and directors will avoid the many sleepless nights that other corporate executives experience when they and their companies are the subjects of a prolonged and invasive federal criminal investigation.

Please email the interviewee at [jlacey@connellfoley.com](mailto:jlacey@connellfoley.com) with questions about this interview.