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The Institute for Law and Economic Policy is a public policy research and educational foundation – a think tank – established to preserve, study, and enhance access to the civil justice system by all consumers.

The goal of the Institute for Law and Economic Policy (ILEP) is to formulate policy positions on issues involving the administration of civil justice within the American legal system. These issues include existing legal protections of all consumers and protection of the public interest in maintaining a safe environment. In addition, ILEP has especially focused on issues of government regulation, preservation of competition, and free and fair markets.



*The remarks published here are from ILEP's 12th Symposium held May 5, 2006  
in conjunction with Columbia University Law School in honor of  
Harvey Goldschmid who served with great distinction as  
General Counsel of the Securities and Exchange Commission  
during the tenure of Arthur Levitt and later as SEC Commissioner.*



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**ILEP**

*An investor and consumer rights  
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**12th Institute of Law and  
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*Co-sponsored by  
Columbia Law School*

*in Honor of  
Harvey Goldschmid*

*Dwight Professor of Law, Columbia University  
former Securities and Exchange Commissioner*

*with remarks by*

**Arthur Levitt**

*former chair of the Securities and Exchange Commission, and*

**Joel Seligman**

*President, University of Rochester*





## Remarks by Arthur Levitt, Jr.

Thank you for that kind introduction, and for inviting me to this conference in honor of our good friend and esteemed colleague, Harvey Goldschmid.

All of us who have worked at the SEC recognize that the long-standing reputation of the Commission, domestically and internationally, is in large part a function of its traditions. In turn, traditions are established by the quality of leadership and the selfless commitment of the people working at the agency. And no one person personifies the traditions and qualities of excellence of the SEC like Harvey Goldschmid does.

For those who have sat in the Chairman's seat, we recognize – in those rare moments of introspection – that so many of the matters we take credit for . . . and that the press and public praises us for . . . are the product of the labors, intellect, and creativity of those who work for us.

**Harvey's patience, his humanity, and his gentility...got me and my successors through so many difficult moments.**

Many times as I responded to legislative grilling at interminable hearings, spoke to a hostile press corps, or responded to angry constituents, I thought to myself: that this was Harvey, not Arthur. Not because I wish it was he at the receiving end of that fire . . . but because it was his wisdom, his patience, his humanity, and his gentility that got me and my successors through so many difficult moments.

When I think of Harvey's career, I am reminded of how rare a breed he is. Not only can he bridge the chasms between the interests of business and investors, labor, academia, and regulators, but he also did so in a way that made him a role model to others.

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We live in an era where it's hard to point to a figure of prominence and say that they are a standard-setter for what it means to serve the public...that they can be an ethical guidepost. Harvey Goldschmid is one of these people.

At the SEC, he brought balance and reason to the job. He held the line when others wanted to trample the rights of investors. He conceived of and helped implement reforms – such as Reg FD – that will be looked upon by investors for years to come as critical to the fair operation of the markets.

Indeed, when Joel Seligman writes the next chapters in the history of the SEC, Harvey's name will be prominent. He will be recognized as a great teacher...a creative, intelligent, and sensitive lawyer...the finest general counsel in the history of the Commission...and one of the most distinguished and effective Commissioners ever to serve.

**For the first time in its history, the SEC is being challenged legally and politically.**

As we meet today, events have placed the Commission at a great turning point. For the first time in its history, the agency is being challenged legally and politically. The anger of various constituent groups and their willingness to challenge the Commission's authority is, in my view, a serious threat to its relevance.

An erosion of the power and influence of the SEC would be a tragic blow to the interests of markets, investors, and the nations continuing primacy as the world's foremost capital market.

This is a time for serious self-examination. A time to revisit the relationship between the Commission, the markets, the Congress, its international counterparties, and state regulators. In effect, it is necessary to rekindle the flame, to recommit ourselves to creating a market with fair and fierce competition that offers the same shot at success for the small investor and the large one.

Doing so requires us to realize that change is inevitable.

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Our markets are too dynamic to think that one solution passed at a given point in time would be adequate for all time. There is no “right” path that can be locked in and followed. It’s like driving a car – even when you set the cruise control, you still need to have a hand on the wheel, constantly adjusting to changing circumstances while keeping your ultimate destination clearly in mind.

And it requires us to resist those – in the courts, in the Commission, and in the halls of Capitol Hill – who want to turn around and go back to the past... who want to lead us back down the path of retrenchment.

After all, they say, it’s been more than three years since Sarbanes-Oxley was passed; Ken Lay is on trial; and the stock market is robust. For them, it’s time to return to how things were -- as if the abuses of the 1990’s were something to celebrate and the strong market of today happened by accident.

**Moving forward..,  
it is not enough to  
resist the forces of  
retrenchment.**

Make no mistake: these are powerful interests uninterested in change... and unwilling to work with regulators and investors to improve disclosure, protect investors, and strengthen our markets.

The present Chairman of the SEC has lived up to his commitment to not roll back the initiatives that were implemented before he took office – even those that he may have opposed. And he should be commended for that.

Moving forward, however, it is not enough to resist the forces of retrenchment. There are a whole host of issues that the Commission should examine and act on... commonsense reforms that will further strengthen our regulatory regime and our markets.

I want to spend a few minutes talking about a few of them, and then I’d be happy to take your questions.

First, perhaps the biggest issue facing the Commission – and at the top of the anti-reform agenda – is the question of whether or not small busi-

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nesses should be exempted from compliance with Section 404 of Sarbanes-Oxley.

The small business lobby – one of the fiercest in Washington – as well as other groups who oppose Sarbanes-Oxley have made their voices heard. Complaints of onerous costs to bring small companies' internal controls up to par – and to test them – have spurred the creation of an SEC Advisory Committee on the issue. And a few weeks ago, this Committee made its recommendation.

I won't cast doubt on the Committee's intentions. After all, I do believe that this is a serious issue. Small businesses are the engines of our economy, and we cannot afford to hinder their growth.

Yet, the Committee's proposed changes would harm small companies, not help them. Exempting smaller and microcap companies – about 80 percent of all public companies – from the requirements of Section 404 would undermine trust in our markets and make it harder for these firms to attract capital.

How?

Just look at the facts. Smaller companies are the most likely to have financial reporting problems. Over the past five years before 2004, nearly 75 percent of all financial restatements were reported from companies with annual revenues of less than \$500 million. If one exempts these companies from internal control requirements – which they clearly need – then one increases the risk premium for investors. This separate, lower standard would relegate small businesses to being second-class citizens in the marketplace, and hinder their growth as much as any allegedly onerous regulation.

I am heartened by the comments from many members of the SEC that

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seem to indicate that they do not believe that exemption is the answer. But what is? Moving beyond the debate over exemption, how can we make compliance easier and less expensive for small businesses?

I believe that instead of exempting companies from rules, we need to help them comply with the high standards that we set.

To start, we need to redefine what constitutes a small business in the eyes of the SEC so that a complex company does not skirt scrutiny because of low market cap – and a company with high market cap, but relatively simple operations isn't forced to perform tests that are unnecessary or unwarranted.

That's why the current definition of a small business issuer should be updated to include companies with up to \$50 million in revenues and fewer than 250 employees. If they have been able to attract more than \$100 million in public capital, they should be ineligible for small business filer status.

Next, the SEC and PCAOB should urge accounting and financial executive trade groups, as well as the software industry, to work together to develop reasonably priced tools tailored specifically for small companies and the small accounting firms who mainly audit them. And the tools must be made available before 2007 when small companies are required to comply with Section 404.

In addition, the SEC must reconfigure itself to provide more readily accessible assistance to small companies. If the SEC placed those that review small business filings closer to the businesses – in its field offices – and supplemented its staff with a small group of accountants that can answer questions small companies might have, it would help avoid restatements and reduce costs.

Finally, while the SEC and PCAOB have issued some helpful guidance on how to streamline the auditing of internal controls, they should go further in easing requirements while stepping up enforcement.

If a company has documented monitoring controls, and the monitoring process has not discovered any problems except for isolated cases, then no

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further internal examination by the company should be required. Companies should be given credit for doing the right thing, and not have to pay to recheck what they are doing right. However, if the auditor finds that monitoring controls have not been working and financials need to be restated, then a company should expect a swift SEC enforcement action.

These steps should help small companies without gutting Sarbanes-Oxley and without undermining faith in our markets.

But in approaching this issue, let's not forget that accessing capital in the public markets is not a right; it's a privilege. And if a company can't meet the standards of conduct that this privilege entails, then perhaps it shouldn't be in the public markets in the first place.

Second, the biggest piece of unfinished business post-Sarbanes-Oxley is the issue of exorbitant, unwarranted executive compensation.

**...the biggest piece of unfinished business post-Sarbanes-Oxley is the issue of exorbitant, unwarranted executive compensation.**

This is an issue that seems never to fade from the headlines for long – partly because there is an endless supply of instances where executives are paid lavish compensation and retirement packages that are out of line with their companies' performance...and any sense of propriety on the part of the public.

These compensation packages set up a system in which executives have the wrong incentives: to manage the numbers for short-term gain and personal payout, and not manage the business for long-term growth and shareholder value. They undermine good corporate governance – sending a signal that boards are willing to spend shareholders' money lavishly. And they damage any standing business leaders could have – and should have – with the public on issues important to their industry and to the nation at large.

I am glad that the SEC has decided finally to take up the issue of executive compensation. It's critical that investors are presented with detailed,

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easily accessible information about the total compensation packages for top executives, who is determining them, and why they are being paid.

And I hope that any final rule also includes disclosure of the top five highly compensated employees beyond the senior management. Shareholders deserve the full picture.

But once companies do their part investors must do theirs as well.

If they want change, shareholders must exercise their right to vote – and exert their strength in a constructive manner. That may mean careful consideration of the shareholder access proposal that Harvey put forth. Or it may mean just exercising the power that shareholders have now.

**For any real change to occur with executive compensation, shareholders – especially institutional investors – must make their voices heard.**

Recently, there was a big hue and cry about the retirement package for the outgoing CEO at Pfizer. But come time for the meeting, the directors that approved that plan won re-election by at least 70 percent of the vote. That sends one message and one message only: that such a pay package was acceptable to a vast majority of shareholders.

Now imagine if the shareholders backed up their complaints with their votes. The message would have been heard loud and clear in boardrooms across America.

For any real change to occur with executive compensation, shareholders – especially institutional investors – must make their voices heard.

Third, all these regulations are not worth the paper they're printed on without real leadership. It's the critical ingredient for making our capital markets and economies work.

Specifically, on the regulatory side, it's time to fill the PCAOB chair – and fill it with someone who is a symbol of probity and integrity in way that Bill McDonough was. And it's time to fill the post of Chief Accountant of the

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SEC. With so many important issues up for debate, we can't afford to keep that chair vacant.

On the corporate side, we need business leaders who recognize the public obligations of the private sector...who take seriously the concerns of all stakeholders...and who put the interests of their shareholders above their own.

There is now no room for the muscular CEO of the 1990's who would buy a company with a stroke of the pen, lay off 10,000 with another, and drive up earnings to rake in millions in stock options.

Now, we need business leaders interested in building value for the long-term, concerned with ethical standards, and committed to his or her shareholders.

With people's perception of business almost as low as their perception of politicians, the most astute businesspeople have to be mindful that a commitment to the public interest is really the only way to restore public confidence. Extraordinary pay packages and retirement packages...staunch opposition to any attempts to improve disclosure and independence...and using their power to win more handouts from Washington – all of these behaviors stand in the way of winning any measure of general support among the general public. And without that support business will suffer.

That does not mean that executives should ignore the bottom-line – of course not. But they must be – in the words of the legendary leader of Goldman Sachs, Gus Levy – not just “greedy, but long-term greedy.”

Companies need leaders who will get out in front of the curve...not just reacting to scandal, but who constantly are working to raise the level of ethics in their companies and their industries.

They need executives who understand their role as citizens – who recognize what they contribute to the national debate. Whether it's involve-

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ment in improving our schools, our immigration policies, or homeland security, these visible public roles integrate business leaders in to the fabric of the country's leadership, and ultimately, help both.

For the better part of the last decade, we had a citizen like this working at the Commission in the form of Harvey Goldschmid.

**Too often, lawyers are used as enablers to get around or skirt the requirements of the law. This is not only borderline unethical, it is also unwise.**

But where will the next Harvey Goldschmid's come from?

I saw a report a few months ago about a Duke University study which found that of all undergraduates, business students cheat the most – with more than half cheating on written assignments. The lead investigator behind the study told Businessweek that when the researchers probed deeper as to why they cheated, a disturbing number of them cited the recent corporate scandals to justify their behavior.

Leadership matters. The examples executives set matter – for the firms and companies they lead as well as for the employees we hope to hire in the future.

And the advice they receive matters too. Too often, lawyers are used as enablers to get around or skirt the requirements of the law. This is not only borderline unethical; it is also unwise. Meeting the minimum standards of governance or corporate behavior yields minimal results in terms of public and political support as well as regulatory flexibility.

That's why in addition to writing the rules and the regulations, we need to create cultures -- in our universities, law firms, and corporations -- that nurture responsibility, ethical behavior, and public spiritedness.

We need business and legal leaders who look beyond their narrow, short-term interests and understand how critical a strong and fair SEC and regulatory regime is to the strength of our capital markets and our economy.

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We need to create the next generation of business and legal leaders that can be entrusted with helping not just their industries, but their country through difficult times. Yes, we need more Paul Volkers, Pete Petersons, John Whiteheads, and Harvey Goldschmids.

Because creating this class of sensitive, public-spirited, private sector leaders is the only way that we can truly guarantee the health of our markets and the strength of our capitalist system.

Thank you.





## Introduction of Harvey Goldschmid

By Joel Seligman

President, University of Rochester

There are very few pleasures in my career quite as special as introducing Harvey J. Goldschmid. Today he is widely and appropriately lauded for his many contributions to antitrust, corporate, and securities law and his career at the Securities and Exchange Commission as General Counsel and Commissioner. Harvey is also my closest friend in academia, and our friendship began literally in the first hours of my professional career.

I first met Harvey during the summer of 1974. I had just graduated from Harvard Law School and in August began work for Ralph Nader on a project that culminated in a proposal for federal chartering of major corporations. Harvey was a young professor at Columbia Law School and a protégée of former SEC Chair and then Columbia law professor Bill Cary. On my first day on the job, I attended a conference, I believe, in the Rainbow Room of the Plaza Hotel in New York City. I remember Harvey speaking about restructuring the board of directors, among other things, to go to an entirely non-management board. I was struck particularly by his maturity. He must have been at least 34 years old when he delivered his remarks, but he conveyed a sense of mastery of the subject and articulated themes that others, soon including Bill Cary, would also address.

**As a sometime historian of the Commission, I have some confidence that Harvey Goldschmid has become the most influential SEC Commissioner who did not become Chair in the Agency's history.**

Our friendship began. Harvey encouraged me to pursue an academic

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career a few years later. I was startled and ultimately grateful for his confidence in me. I consulted him every time I had a major life decision, and with the possible exception of the late Al Sommer, Harvey read more drafts of more manuscripts I prepared than any other living individual I know. He was the Dutch uncle that everyone should have, a person of boundless patience and extraordinary and sensitive intelligence.

The first five years of my academic career were devoted to writing *The Transformation of Wall Street*, a history of the Securities and Exchange Commission. In 1982 I dedicated *Transformation* to Harvey in gratitude for his friendship and his encouragement of my academic career. I did not realize then how remarkable his contributions to securities law would ultimately prove to be. As a sometime historian of the Commission, I have some confidence that he has become the most influential SEC Commissioner who did not become a Chair in the Agency's history. Since this is an agency that has been blessed with some extraordinary Commissioners, I mean this encomium as the highest possible praise.

Harvey's relationship with SEC Chair Arthur Levitt initially as an advisor, then as general counsel, was a particularly consequential one. Harvey was the lawyer's lawyer who could supervise the drafting of the revision of the pivotal SEC Rule of Practice 102(e) and help draft Regulation FD. He had the ability to translate Arthur's policy preferences into proposals which were wise, sound, and feasible. On issue after issue ranging a gamut from accounting independence to bank regulation, Harvey's efforts were pivotal to the success of Arthur Levitt's chairmanship.

During the chairmanship of Harvey Pitt and Bill Donaldson, Harvey continued his service as a Commissioner. His inevitable preference was to work quietly and behind the scenes to help craft the most appropriate

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consensus policy as possible at the SEC. His term as Commissioner should be remembered for quiet victories on a myriad of issues implementing Sarbanes-Oxley rules, among many other topics.

**But Harvey's period as Commissioner will also be remembered for a small number of very public occasions on which he took a stand on principle.**

But Harvey's period as Commissioner will also be remembered for a small number of very public occasions on which he took a stand on principle. His statement opposing the confirmation of Bill Webster as the first chair of the Public Company Accounting Oversight Board was a profile in courage. Harvey knew and admired Bill Webster. Harvey has a rare gift for friendship which made opposition to so extraordinary a man as Bill Webster particularly painful. The transcendent issue, however, involved the dysfunction in an appointment process that had earlier offered the chairmanship to then TIAA-CREF Chief Executive Officer John Biggs and where subsequently an SEC Chair failed to share material information with fellow Commissioners. These were inexcusable failings and Harvey, politely but firmly, said as much when Bill Webster was confirmed by a 3 to 2 vote over Harvey's dissent. The bungling of the confirmation of Webster became a proximate cause of the subsequent resignations, both of Bill Webster and SEC Chair Harvey Pitt. Never in the history of the SEC were relations among Commissioners as strained as they had been during the last tempestuous months of Harvey Pitt's chairmanship.

Sometimes institutional courage is rewarded. During the subsequent chairmanship of Bill Donaldson, the Commission had a new chair, expanded budget, and initially dramatically improved morale. Harvey's role in some respects was even more remarkable working with Chairman Donaldson than it had been working with Chairman Levitt. The two, although in different parties, worked well and constructively together. Donaldson in many instances grew to trust Harvey's judgment as much as Levitt had. To be sure there were occasional differences, most notably over shareholder proxy access. But these were dwarfed by the number of issues on which Bill Donaldson and Harvey Goldschmid worked constructively together.

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History is the study of consequences. In a certain sense the ultimate history of the Levitt, Pitt, and Donaldson chairmanships cannot be written for decades because only in retrospect will the full implications of the statutory rule and enforcement developments of the Commission be capable of appreciation.

Nonetheless, even as proximate in time as we now are to Harvey's service as an SEC Commissioner, it is possible to articulate some tentative judgments.

On a personal level, Harvey Goldschmid's contributions to the SEC and corporate and securities law in general were always marked by a sense of gravitas, a mastery of complexity, an ability to distinguish issues on which compromise was appropriate from those in which matters of principle had to dominate. Harvey Goldschmid was by instinct a lawyer's lawyer who loved to work quietly and thoughtfully on systematic review policy, who throughout his career increasingly became a public persona defending the systems of full disclosure, ethical behavior, accountability, and effective institutional structure with an increasingly powerful voice.

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Throughout his career Harvey published a good deal, but in many respects he should receive particular credit for being the drafter or editor of significant institutional documents. For many years Harvey was one of the reporters on the American Law Institute Principals of Corporate Governance project. Perhaps the most effective part of this document is Part IV which addressed the business judgment rule and duty of care which Harvey took years drafting and revising. He is a good illustration of an adage I have often repeated, "To lead, listen." Harvey not only listened; he heard and found a way of articulating these pivotal corporate law concepts in ways that strengthened shareholder protection and strengthened corporate effective-

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ness at the same time. Similarly, his work, for example, on Rule 102(e)(iv) of the SEC Rules of Practice is but four short paragraphs long. These paragraphs, nonetheless, masterfully articulate

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“improper professional conduct” in ways that ended years of litigation and over time have proven to be effective for the auditing profession.

In the broadest sense Harvey Goldschmid's career reflected a determination to improve the integrity and accountability of business corporations consistent with their most efficient operation. There was a pivotal element of balance in his work. Harvey was capable of transforming shouting matches on issues concerning the corporate board into thoughtful discussions of how a new standard actually should operate and what would be the costs and benefits or wisdom of proceeding with a standard. He had an unerring genius for appreciating the operational implications of new rules.

He has now returned to his beloved Columbia Law School and renewed his career as a law professor. I always held him in awe for his classroom abilities. He was capable of memorizing the names of each of frequently many more than 150 students and orchestrating a dialogue that involved all of them in reasoning through a case or concept. The students of Columbia Law School are the immediate beneficiaries of his pedagogy.

But all of us who have had the opportunity to hear, talk to, or work with Harvey Goldschmid are the ultimate beneficiaries of his multifaceted career. Very rarely in life do you meet a scholar and government official who both makes great contributions to public policy and is a good man. In my lifetime, I have never met one who was the equal of Harvey J. Goldschmid.





## My Time at the SEC: A Tentative Appraisal

(Excerpts from remarks of Harvey J. Goldschmid  
at the 12th Annual ILEP Conference held on May 5, 2006)

Joel that was a lovely introduction. I am deeply grateful that this important conference has been held in my honor. A fair number of the nation's leading academics, public officials (including judges), and practitioners are here, and this has been a hallmark of prior conferences sponsored by the Institute for Law and Economic Policy. ILEP conferences have generated scholarship and policy proposals of great merit. Conferences of this quality (papers from this conference will be published in the Columbia Law Review) are very much what the nation needs. Ed Labaton and the others at ILEP should feel very proud of what has been accomplished.

I must specially thank Arthur Levitt and Joel Seligman, two of the people I like best in the world, for their very kind comments about me. I'm delighted that my wife Mary was here to hear their words and that my three sons will be able to read them. Hyperbole can be quite wonderful.

I took office as a Commissioner of the Securities and Exchange Commission on July 31, 2002. July 31 was the day after the Sarbanes-Oxley Act was signed into law. Our financial markets were then in turmoil, and the corporate community was in disrepute. Today, and this may reflect the "optimism" Arthur Levitt spoke about, although things are still imperfect, because of Sarbanes-Oxley, the SEC's efforts, and private litigation a large element of public distrust has disappeared.

**If helping to restore public trust and confidence had been the only accomplishment of Sarbanes-Oxley, the SEC, and plaintiff's attorneys I would gently praise what has been done.**

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**...right now, private actions are more than, in traditional SEC words, "a necessary supplement to the Commission's efforts"; private actions are absolutely essential if our securities regulation system is to work.**

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made things better.

But let me quickly put the enactment of "good legal rules" in perspective. In 2002, at the beginning of my SEC service, I told the SEC's Enforcement Division that in a "perfect world (i.e., where everyone obeys the law) the kind of extensive rulemaking the Commission was about to undertake would just about put them out of business." But I went on to tell the Enforcement attorneys not to worry about their job security. The world is quite imperfect and even good rules are of only limited value unless they are enforced by public and private legal actions. Today, given the business

would gently praise what has been done. But I believe that much more than the atmosphere has changed. Critically important substantive changes have been made in U.S. corporate and securities laws, and they will be with us well into the future. In terms of corporate accountability, financial disclosure, and the functioning of our financial markets, U.S. law is dramatically better today than it was just four years ago.

Let me begin my tentative appraisal by stating bluntly my basic bottom line to the scandals of the 1990's and early 2000's. We have witnessed a systemic failure. The checks and balances that we thought would be provided by independent directors, independent accountants, securities analysts, commercial and investment bankers, lawyers, and compliance personnel (particularly for mutual funds) too often failed. In each of these areas of "systemic failure," new good legal rules have

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backlash that is occurring and serious threats to SEC enforcement created by sharp limits being imposed on the SEC's resources, the jobs of the plaintiffs' attorneys among us tonight are also secure. Indeed, right now, private actions are more than, in traditional SEC words, "a necessary supplement to the Commission's efforts"; private actions are absolutely essential if our securities regulation system is to work.



