

HLP Remarks
42nd Annual Rocky Mountain Securities Conference
“Swimming in Uncharted Waters: Ethics and the Life of the Lawyer in the Current Markets”
Denver, Colorado
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A gracious good afternoon! I bring you greetings from your Nation’s Capitol!

When my good friend, Bob Davenport, called and invited me to speak at this venerable Rocky Mountain Securities Conference, I didn’t pause a second before accepting, and it wasn’t solely because my younger son, Rob, is spending his four-year vacation and sporting good time that we call college a stone’s throw from here. I confess that having the chance to look in on him was a factor in my decision. Rob loves it out here so much, he isn’t inclined to travel back East in the absence of some compelling reason—that is, a compelling reason to him, mind you, not what his mother or I think is compelling! And, truth be told, I only get to speak with Rob when he needs money. Of course, the good news is that means I get to speak with him nearly every day!

Other factors also played a prominent role in my eagerness to spend some time with you today. Among these is the fact that Bob and I go back a long way together. We, Judge Sporkin and Commissioner Walter were colleagues at the SEC when the SEC was the basher, rather than its current, unwarranted, status as an institutional piñata. Back in the day, when I was the Commission’s GC, Bob invited me out here frequently, and kept on inviting me even after I deserted him and the Commission for the private sector. Given our shared history, and my enormous admiration and respect for him, there just aren’t many things Bob could ask of me that I’d turn down.

I also was motivated by the opportunity to see so many old friends. Perhaps I should say long-standing, rather than old, friends. This is a very special symposium, now into its fifth decade, that brings together SEC senior staff, regional enforcement authorities so vital to the SEC’s work, and some of the most experienced and knowledgeable private sector lawyers, to discuss issues of current importance. I suppose that begs the question of what I’m doing here, but why go there? It’s extraordinarily gratifying to see, especially judging from the number of people present, how this conference has flourished as one of the Country’s premier securities continuing legal education events.

I was asked to share my perspective on the current and prospective regulatory landscape, as well as my thoughts on how lawyers and business professionals can best navigate the securities and governance challenges we all face from the incredible financial crisis in which we’re still mired, and the anticipated tidal wave of regulatory change we’re all facing. Recent events prompt me also to talk about what I perceive as the dismal quality of responses by firms confronting more individualized crises that tangentially relate to our economic woes, and the advice they’re apparently receiving. We deserve something more and better from these businesses, and they, in turn,

deserve something more and certainly something better from their advisors. My goal isn't to attack these businesses or their advisors, but to call to your attention what seems to be an alarming trend of businesses that apparently have lost their way.

For those of you with troubled looks on your faces, surely you didn't think I'd changed all that much in the seven years since I most recently left the SEC. It's hard for an old dog like me to learn new tricks. I'll try to be sensitive to your digestive processes, but forewarned is forearmed.

The Current Environment

In case you've been traveling, we're suffering through a terrible economic crisis of draconian proportions. Many of us would like nothing more than to believe our political leaders who tell us prosperity is just around the corner, but that's no more accurate today than it was in 1929, when we were last told that. I don't fault politicians for claiming things are about to get better. One alarming facet of the current crisis is how large a role fear, panic and loss of confidence played in the economy's significant downward spiral. But, that doesn't mean we should accept unthinkingly what we're being told. The most significant indicator of our continuing economic struggle, in my opinion, is the fact that we've spent over a trillion dollars in the last two years, but unemployment continues to rise.

And, doling out billions of dollars to the same companies that contributed to our economic meltdown isn't the way to improve employment. It wasn't all that long ago that a major bank received \$350 billion from the government, and contemporaneously announced it had cut 50,000 jobs. Companies in economic extremis that receive unbelievable amounts of *our* money invariably use that money to prettify their balance sheets, not jumpstart the economy. If we're going to give away money, shouldn't we at least give it to those most likely to spend it, and help revive our flagging economy? Lest you think that's a political comment, keep in mind that this effort of business doles started in the last Administration, but continues in the current one. The litany of mistakes made in dealing with this crisis is the one truly bipartisan element we've seen in Washington, recently.

In the face of this economic disaster, we're about to implement far-reaching changes in our financial regulatory system. We *need* far-reaching changes, since our regulatory system's failure created much of the mess we're in. The problem is that we don't need many of the specific far-reaching changes we're about to receive. I say that not because I oppose serious reform, but rather because I believe that, when confronting a crisis, it's usually a good idea first to identify the causes of the crisis, and then craft legislative and regulatory solutions to address them. But, that's not how we're currently doing it in Washington. Instead, Congress is en route to enacting 1400-page laws and, several months later, will receive a report from the Financial Crisis Inquiry Commission on what caused the crisis.

We might luck out, and address the actual causes of our current crisis without first identifying them, but I wouldn't bet on that. In fact, I'd sooner be long Abacus

CDOs from Goldman Sachs than assume these legislative monstrosities will help prevent or ameliorate our next crisis. I can understand not waiting for the FCIC to finish its work before passing legislation, however. You can't watch that effort without recalling Macbeth's description—much sound and fury signifying nothing. While dueling sound bites may be amusing, there's a real crisis going on, and we desperately need adult leadership to help resolve it.

Apart from the obvious problems many are suffering, economic hardship and financial meltdowns tend to bring out the worst in those responsible for guiding us through the problem and laying the framework for preventing future disasters of a similar nature. That's why Washington's now fallen back on its classic mantra—it's not how you play the game, it's where you place the blame! In the face of a crisis, there are two broad categories into which folks fall—those who want to solve the problem, and those who seek to take advantage of it. Unfortunately, in a true crisis, we invariably have far too many of the latter, and not nearly enough of the former. Moreover, the finger-pointers often divert attention from the real causes of our problems, making it harder to solve them and reduce the likelihood of their recurrence.

George Bernard Shaw once cynically observed that “the *only* thing we ever learn from history is that we *never* learn from history”! Given the severity of our current economic crisis, I hope Shaw's proven wrong, at least this once. We *must* learn from recent history, and replace our outmoded and broken regulatory and enforcement systems with more effective techniques and better tools to combat the inevitable next crisis we'll soon confront. Yes, I said the *next* crisis. I'm sorry if I sound unduly somber, but there's no doubt we'll confront our “next” crisis before too long; the only certainty—apart from the fact that there'll be a next crisis—is that it probably won't look anything like our most recent past crisis.

That's what makes this past year and a quarter so incredibly disappointing. In that time, we've spent trillions of dollars, without

- materially improving the regular and systematic availability of necessary credit, especially to mid and small-cap firms;
- ending the self-perpetuating cycle of job losses, followed by decreased consumer spending, followed by corporate retrenchments in spending, followed by additional job losses; or
- fixing the systemic regulatory problems that not only caused our current financial and economic crisis, but threaten additional rounds of economic and financial disasters.

To make matters worse, the bloated regulatory reform proposals we've seen assure us of only two things—first, that no one in Congress has actually read the legislation, and second, that its sponsors are clearly not environmentalists! I have a number of concerns with these proposals:

- Forget about “too big to fail,” these bills are too big to succeed!

- It's unwise to cap the growth of financial institutions—like a broken clock, they may be correct twice a day, but they'll be wrong all the other times
- The legislation effectively creates preferred financial services firms
- It addresses last year's crisis
- It adds bureaucracy, rather than reducing it
- On the one hand, it gives the SEC authority it won't be able to implement successfully while, at the same time, it effectively strips the SEC of existing authority it had at the behest of the Chairman of another financial regulatory body and
- Assures that we're in for plenty of experience with the law of unintended consequences.

What we needed a year and a half ago, and still need today, is legislation that deals with the systemic failures in our current regulatory system. There are three critical things that could, and should, have been done to solve that problem:

- Require a steady stream of significant data to be furnished to the government regarding all those who have a significant impact on our capital and financial markets;
- Mandate that the government analyze that data and disseminate it to the market place, in real time; and
- Authorize the government to impose tripwires so that potentially significant trends can be halted while government figures out what should be done to avoid potential problems.

Corporate Governance and Legal Practice in a Difficult Environment

In these challenging times, given the complexity and magnitude of our current problems and the overwhelming uncertainty concerning what the future holds, the most common response is to freeze like proverbial deer caught in the headlights, doing nothing but waiting to see if we're hit. Of course, to avoid becoming road kill, doing nothing isn't an option. It's precisely during these times of great difficulty and uncertainty that thoughtful leadership, driven by determined and decisive action, is absolutely critical.

This, of course, is easier to say than achieve. But that doesn't mean it can't, or shouldn't, be done. My starting point is a simple proposition—the failure to achieve good governance and uncompromising ethical standards will prevent success, even if cutting corners creates deceptively positive short-term results.

Some corporate lawyers may find it troubling to hear another corporate lawyer tell you that the legality of corporate activities is only the beginning, not the conclusion, of analysis. I believe lawyers have an overarching responsibility to ask not only whether

their clients' proposed conduct can be rationalized with more and more complex laws and regulations, but also whether the proposed conduct is in the best interests of the corporation and its owners, the shareholders. Based on recent high-profile missteps by pillars of the business community, I'm not confident business leaders and their advisors actually get it. Let me offer a few examples for your consideration:

About a year ago, several companies that had received government handouts confronted their contractual undertakings to provide so-called retention bonuses to many of the same employees who were on the scene when the problems that necessitated the original doles arose. You know who I'm thinking of, and there were plenty in that situation. We don't know precisely what advice was sought or given. But, based on the public statements and actions of the affected companies, it's a safe assumption that management must have asked counsel whether their company was legally obligated to pay the retention bonuses, aggregating millions and millions of dollars. The lawyers presumably said "yes, that's an enforceable legal obligation." The problem with that response—as was noted in one of my favorite films, "An Absence of Malice," starring Sally Fields and Paul Newman—was that it was "accurate, but not true."

Shouldn't these businesses have received different advice—to wit, "you may be contractually obligated to pay these bonuses, but let a court make you do that"? The failure to approach this issue pragmatically didn't happen once or twice, it happened repeatedly, with some companies double-dipping, and almost always with the same result—public outrage and the CEO's canning. The amounts of bonuses, while large to a poor boy from Brooklyn like me, probably weren't material, but they were important. And, making those payments wasn't worth hurting the public image of companies already teetering on the brink of extinction.

More recently, two prestigious firms have been publicly accused of improper conduct. One involved a report about the biggest bankruptcy in U.S. history, and the other involved a lawsuit filed by the SEC, charging fraud. When I handled adversarial matters brought by the SEC, I used to start by telling my clients they had to come to grips with the popular public perception that nice companies and nice people don't get sued by their own governments! There's an incredible gap between having strong defenses to government litigation, and surviving serious government allegations of fraudulent behavior. But that distinction appears not to have been appreciated, either by the firms, their lawyers or their pr advisors.

What makes this all the more surprising is that the SEC's case against Goldman Sachs really can't be litigated to a verdict. Unless Goldman can get the SEC's charges dismissed, or obtain a grant of summary judgment—both extremely unlikely outcomes—it cannot afford to test how strong its defenses really are. Why? Goldman manages other people's assets, including assets governed by ERISA. Every litigator in this room will quickly admit that he or she has won cases they shouldn't have won, and lost cases they shouldn't have lost. Do companies really want to bet the farm on their lawyers' conviction that they have strong defenses? I wouldn't. And, before a client of mine did that, I'd want to make darn sure its Board or governing body understands all the risks of

losing. For Goldman, putting aside the loss of \$21 billion in market capitalization, tarnished reputation and other government attacks (equivalent to the football penalty of piling on), there are *automatic* bans on portfolio management activities if they lose and are enjoined.

Thus, if the motions likely to be filed lose, as I believe they will, can the firm risk a holding that says it committed fraud? The question answers itself. And, wholly apart from the legalities, whether the SEC wins or loses, does any business really want existing and prospective customers and clients to believe it might have taken advantage of them for its own profit, even if that isn't actually illegal?

So bad was this entire scenario, that when five Goldman execs testified under oath before the Senate, and were asked by Senator McCaskill whether they thought Goldman had an obligation to treat its clients fairly, four of the five refused to agree the firm did have such an obligation. Would you want to continue doing business with senior executives that take that position? According to the Wall Street Journal today, the folks at AIG, among others, don't want to do that. Why didn't these executives say, at the worst, "of course we must be fair to our clients, but that's not what happened here"? I don't know what advice they sought or received, but Senator McCaskill's question was predictable, and a sound response should have been scripted. Even worse, Goldman didn't have to concede it committed fraud to strike a different image. The CEO could have said—but didn't—we regret the fact that the government felt compelled to charge us with fraud and, while we intend to defend ourselves, we're bringing in some knowledgeable and independent folks of stature to review what we did and help us ensure that things like this don't occur again in the future. No admission, but a display of genuine remorse at being there, and a commitment to the firm's clients that it won't happen again.

And, don't misunderstand. It isn't a problem to argue you've done nothing wrong. But it surely is a problem that Goldman's CEO accused the SEC of political motivations in filing its litigation. Forget for the moment that it isn't true; instead, assume you're the CEO and you genuinely believe that's what happened. Even so, why did *he* have to say it? There were enough other people saying it that the CEO could have taken the high road. If you assume that motions to get rid of the case fail, and you begrudgingly accept that Goldman can't afford to risk losing, how receptive do you think the SEC Staff will be when settlement discussions come around, and the CEO accused them of misconduct? It's a rhetorical question, so let's not dwell on it.

Hard economic times require hard decisions and choices. It may feel cathartic to lash out at the first government agency that sued you, but it isn't smart. I can't think of any major business enterprise that got what it wanted by telling its regulators they're stupid, wrong and venal. It may be okay to think that—and I'm not persuaded of that—but it definitely isn't okay to say it.

Corporate scandals, business cycles and financial crises are inevitable. Despite that fact, many companies, and their advisors, seem ill-prepared for the new climate of accusations, attacks, and suffering, even if they're able to accept—intellectually at

least—that it's coming. Thus, when the process strikes home, many companies simply aren't ready to deal with the consequences, and haven't taken sufficient steps to prevent disaster. The SEC is moving quickly and aggressively to restore its image as a vigorous enforcer of the securities laws, heightening everyone's need to recognize the onslaught can hit their company, and to prepare to respond if and when it does.

There's no legislative or regulatory silver bullet that will change human nature. But that won't stop lawmakers and rule-givers from acting, because those in authority can't—and shouldn't—be inactive in the face of serious misconduct. Thus, it's a foregone conclusion that, whatever else they do, new laws and regulations adopted in the face of the current crisis will reflect significantly reduced tolerance for even questionable, much less outright objectionable, business practices. As a result, corporate governance will undergo profound changes in coming months and years. This means directors will be held increasingly accountable for the effectiveness of management's decision-making and risk monitoring and, more significantly, for their failures. And, in an organizational application of the "trickle down effect," an increased premium will be placed on accountability throughout organizations.

Even with these changes, though, history and common sense teach that government intervention ultimately isn't the answer to minimizing risk, ensuring compliance, promoting good behavior, safeguarding investment potential, and enhancing profitability. So, to paraphrase the old TV commercial, what's a business to do?

I think businesses must understand that "corporate Darwinism" is the metaphorical law of the jungle, where only the fittest companies—those with the most robust governance structures, the best substantive governance and the most ethical personnel—survive and prosper. In such a world, and particularly in the anticipated environment of enhanced scrutiny and reduced tolerance, companies and their managers should understand it's in their *own* self-interest to look beyond specific governmental mandates, toward practicing real compliance and transparency, and insisting on ethical corporate behavior, as an organic part of their businesses.

This is so because, no matter what shape the *external* regulatory landscape takes, the *real* reason companies need, and should want, good governance and consistently high ethics is *not* because of what legislators, regulators, or even plaintiffs' lawyers, impose or inflict; the strongest motivation for good governance and strong business ethics is good old self-interest. More than any government legislation, regulation or prosecution, these are the factors that should drive companies toward ever-improving governance, more accountability, greater transparency and high ethical standards.

Good governance is also self-perpetuating and self-reinforcing. Let's face it; it's not pleasant to deal with investigations, litigation, bad press and the hideous phalanx of lawyers that ineluctably accompany poor governance or employees' unethical behavior. A company with a strong ethical culture and good governance will find it easier to attract

and retain directors and senior managers who support such a culture, and to cultivate a workforce that thrives in that milieu as well.

Corporate governance implies a conscious, deliberate, and consistent effort to minimize undue risk in all its manifestations, which in turn requires ongoing risk assessment *before* a company takes action, *before* its next business crisis arises and *before* it's embroiled in the next economic, market or other external crisis. Risk management must play an increasingly important role in all corporations. Boards and managements need to allocate appropriate resources to ensure the currency of their knowledge, and they need to pursue state-of-the-art risk management controls and techniques.

Lawyers can help their clients fulfill these new obligations, but only if they cease viewing themselves as merely calling balls and strikes. Just because a proposed course of action may be legal doesn't mean it should be pursued. Lawyers need to make sure their clients understand the difference.

Lessons Learned

I'd like to share my ten rules of thumb for how lawyers and business professionals can proactively lead their respective clients and companies to achieving good corporate governance during these turbulent times. I caution you that, although I always promise ten, I never have just ten. But if I'd said I had 11 or 12, you'd tune out, and who'd blame you?

(1) *There's a New Golden Rule.* It's risk management. Unidentified, unquantified and unanticipated risk of all kinds is the enemy. It's critical to invest the resources necessary to establish sound risk management techniques. And, one of the most difficult risks to assess is what I call "personality" risk—that is the risk associated with the personal proclivities of senior managers.

(2) *Transparency's Essential.* Nearly everyone looking at the regulatory environment agrees on the need for transparency, but no one actually defines what that means. That creates both a problem and an opportunity for you, since the age old approach—let's only tell everyone what we're required to tell them—no longer works.

(3) *It's Not Happening to Them, It's Happening to Us.* When we read in the press or otherwise learn of companies that find themselves in deep yogurt, we may succumb to the understandable, but pernicious, tendency to think this has nothing to do with us. But, when any business suffers, all businesses suffer. And the fact is that if we don't look upon the foibles of other companies as cautionary tales, others will be looking at us as their cautionary tale.

(4) *Avoid the "Sara Pitt Syndrome."* Sara Pitt was my beloved mother, a self-medicating health fanatic. She took hundreds of vitamins and minerals daily, and believed she was better than any physician. As a result, when she developed stomach pains, it took us nearly two years to persuade her to visit the doctor. When I called her to get her take on the visit, she somberly told me "You know, Harvey, I was never sick a

day in my life until I went to visit that damn doctor"! That's how many CEOs and Boards operate. They think that just because no one tells them they have cancer, they don't have it. But the real world doesn't work that way. You can, and you must, look for potential problems *before* they come around and bite you in parts of your anatomy you'd rather not have bitten!

(5) *There's No Such Thing as a Small Problem.* Small problems have an annoying habit—left unaddressed they coalesce and morph into big ones. This is particularly true when economic pressures or other external influences act as an irritant. Life's easier if problems are identified and addressed early.

(6) *Shun the Reverse Laissez Faire Syndrome.* This is the syndrome where businesses sit back and wait for government to tell them what they're doing wrong, why it's wrong, and how to fix it, and then, like Claude Raines in "Casablanca," are "shocked, shocked" to discover they don't like government's responses.

(7) *Being Smart's Good; Being Too Smart is Dangerous.* When seeking to make money or circumvent obstacles, it's tempting to develop novel, unique or clever approaches. Making money is to be encouraged, and circumventing obstacles is good, but only if the proposed plan is thoroughly vetted and understood *first*.

(8) *Don't Become a Victim of Your Own Success.* Bill Gates had it right when he observed that "success is often the worst of teachers." That's because when we succeed, we're tempted to believe it was because of something *we* did. But that can ultimately lull us into a false sense of security. If you hope for the best, but plan for the worst, you're likely never to be caught off guard, be unprepared or wind up disappointed.

(9) *Heed Unconventional Wisdom.* Constructive dissent and contrarian thought ought to be encouraged to counterbalance "group think" mentality that, left unchecked, results in the emperor parading naked, while everyone else loses their shirts.

(10) *In the Middle of a Crisis, Be Wary of Litigators.* Litigators want to win the case. Clients want to salvage their company.

(11) *It Usually Gets Worse Before it Gets Better.* These are unprecedented times. There'll be more bad news, and it will take a long time to recover from this crisis. On the other hand, it's not wise to bet against the resilience of Americans and our financial system.

(12) *Maintain a Sense of Humor.* Over the last several years we've probably taken ourselves too seriously. Adlai Stevenson had it wrong when, after losing to Dwight Eisenhower yet again, he somberly intoned, "I'm too old to cry, but it hurts too much to laugh." If you don't laugh, the pain is only that much harder to handle.

Conclusion

Navigating these uncharted waters is daunting. But, now's the time to strengthen resolve, not grow discouraged. As Justice Oliver Wendell Holmes, Jr. noted, "Greatness isn't in where we stand, but in what direction we're moving. We sail, sometimes with the wind, sometimes against it--but sail we must, not drift or lie at anchor." I'm confident—and hope you are, too—that, no matter how difficult our times, with thoughtfulness, creativity, patience and exacting care, we can surmount almost any obstacle. Thank you.