

Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 1

Issue 1

SYMPOSIUM:

New Models for Securities Law Enforcement:
Outsourcing, Compelled Cooperation, and
Gatekeepers

Article 2

2006

Introduction to the Symposium

Linda Chatman Thomsen

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/bjcfcl>

Recommended Citation

Linda C. Thomsen, *Introduction to the Symposium*, 1 Brook. J. Corp. Fin. & Com. L. (2006).

Available at: <https://brooklynworks.brooklaw.edu/bjcfcl/vol1/iss1/2>

This Article is brought to you for free and open access by the Law Journals at BrooklynWorks. It has been accepted for inclusion in Brooklyn Journal of Corporate, Financial & Commercial Law by an authorized editor of BrooklynWorks.

INTRODUCTION

STANDING ON THE SHOULDERS OF A GIANT

*Linda Chatman Thomsen**

Thank you and congratulations to everyone here at Brooklyn Law School and at the Securities and Exchange Commission Historical Society responsible for putting together this very important and timely program, especially Dean Wexler, Professors Janger, Karmel and Poser of Brooklyn Law School and Carla Rosatti of the Historical Society. Congratulations are definitely in order for the students responsible for launching the *Brooklyn Journal of Corporate, Financial & Commercial Law*, which promises to be a terrific journal. Before I forget, let me remind everyone that my views are my own and do not necessarily reflect the views of the Commission or any other member of the staff.

It is a special treat for me to be here in Brooklyn, which I associate with the beginnings of my professional life. The summer I was a summer associate I lived with my aunt and uncle in their wonderful apartment over the even more wonderful restaurant they owned and operated, Gage and Tollner's. When I started practicing full time, a year or so later, my first apartment was a few blocks from here in Brooklyn Heights, on Montague Street, over a Haagen Dazs ice cream store. No wonder my memories of Brooklyn are so favorable—they include great food.

But the best treat today is to be able to join everyone here in honoring Irving Pollack; a 1938 graduate of Brooklyn College, a 1942 graduate of Brooklyn Law School, and a living legend in the legal and securities world. Much has been said about Irv at this conference, but I thought it was worth noting a few things. In 1967, after spending over two decades on the staff of the Securities and Exchange Commission, Irv received the SEC's Distinguished Service Award. It is the Commission's highest honorary award, designed to recognize those who have made major contributions to the work of the Commission and the administration of the federal securities laws. It was richly deserved for all of Irv's wonderful work. But as it turns out, it was premature. After receiving that award, Irv remained at the agency for thirteen more years during which time he became the agency's

* Linda Chatman Thomsen is the Director of the Securities and Exchange Commission's Division of Enforcement. She has been a member of the Commission's Division of Enforcement staff for over ten years. She joined the staff in 1995 as an Assistant Chief Litigation Counsel. In 1997 she was named an Assistant Director and was named an Associate Director in 2000. She became the Deputy Director of the Division of Enforcement in 2002. In May 2005, she became the eighth Director of the Division of Enforcement. Before joining the staff of the Commission, Ms. Thomsen was in private practice and also served as an Assistant United States Attorney for the District of Maryland. She received her A.B. from Smith College and her law degree from Harvard University.

first Director of Enforcement and thereafter one of its Commissioners. His career has been and continues to be an example to us all.

Late in the 17th century, Isaac Newton wrote in a letter to fellow scientist Robert Hooke, “If I have seen further, it is by standing on the shoulders of giants.”¹ It is a quote you often hear about the debts people owe their predecessors. If you Google the phrase, as I did, you learn that at time the letter was written, Newton and Hooke were actually in the midst of some long-simmering feud, replete with accusations of plagiarism and theft of research and ideas. You also learn that Hooke himself was reported to be quite short—not, in any event, a giant. So, Newton’s words to Hooke, while on the surface polite, may have been intended as an insult.² All of this I found a bit discouraging until I learned that the sentiment expressed by Newton was a relatively common and formulaic notion among scholars and scientists dating back to at least the 12th century.³ Twelfth century scholar John of Salisbury wrote: “We are like dwarfs sitting on the shoulders of giants. We see more, and things that are more distant, than they did, not because our sight is superior or because we are taller than they, but because they raise us up, and by their great stature add to ours.”⁴

I think of this phrase often when I think about my predecessors in my job as Director of the SEC’s Enforcement Division and the staffs they led. Our work today is based on a rich and proud foundation laid by those predecessors—and the basis for that foundation—the first bricks, if you will—were laid out by Irv Pollack. Among other things, it was our former Enforcement Division Directors who established: our independent litigating authority, our ability to seek disgorgement as a matter of equity (which was later codified), our penalty remedies, and the development of insider trading principles now recognized in the federal securities laws. They were also among the first to breathe life into our investor protection mission.

Further proof of their work in setting the foundations of the Enforcement Division can be seen in today’s topic: “New Models for Securities Law Enforcement: Outsourcing, Compelled Cooperation and Gatekeepers.” I wish I could have seen Irv’s face when he first saw this topic, because I think he must have found these novel ideas to be quite

1. Letter from Isaac Newton to Robert Hooke (Feb. 5, 1675), in THE COLUMBIA WORLD OF QUOTATIONS No. 41418 (Robert Andrews et al. eds., New York Columbia University Press 1996), available at <http://www.bartleby.com/66/18/41418/html>.

2. See, e.g., Warble, http://www.warble.com/blog/archive/2004_10_01_archive.html (Oct. 10, 2004, 00:54 EST) (discussing the origin of the inscription “Standing on the shoulders of giants” on the United Kingdom’s two pound coin); Joseph N. Yoon, On the Shoulders of Giants (Feb. 8, 2004), <http://www.aerospaceweb.org/question/history/q0162b.shtml>.

3. See generally ROBERT K. MERTON, ON THE SHOULDERS OF GIANTS: THE POST-ITALIANATE EDITION (1993) (tracing the history of the phrase).

4. See Yoon, *supra* note 2 (quoting John of Salisbury, *Metalogicon III* and explaining the history of the quote); Wikipedia.org, Standing on the Shoulders of Giants, http://en.wikipedia.org/wiki/Standing_on_the_shoulders_of_giants (last visited Nov. 7, 2006) (attributing similar quote to Bernard of Chartres, quoting John of Salisbury).

familiar. While it is certainly true we are using these models—and I may quibble with the adjective “compelled”—there is nothing new about them. Irv and his colleagues used them all. When we use them today, we are indeed standing on the shoulders of our predecessors and building on the foundations they laid.

As the program materials note, SROs have been around as long as there have been federal securities laws, cooperation has been the name of the game since the beginning of enforcement (notably in the foreign payments arena), and the notion of gatekeepers—I think Irv and his colleague Stanley Sporkin called it “access theory”—has also been around for as long as we’ve been in this business. These ideas have been around from the beginning for very good reasons. First, industry numbers: there are far more people in the business than the number of people watching it. A recent conference sponsored by the Securities Industry Association was attended by 2000 legal and compliance people—twice as many as we have in SEC Enforcement Division—but they comprise only a tiny fraction of the vast number of people who make their livelihoods in the securities industry. Second, the securities industry is a legitimate business based on investor trust and confidence, and people in the business have every incentive to keep it that way. Even if we in law enforcement were sitting around eating bonbons—and we aren’t—the securities industry would want to make sure illegal behavior was rooted out and stopped. Third, and related to the first two points, the use of gatekeepers may have exponential deterrent effects throughout the industry. Gatekeepers—accountants, lawyers and other professionals—are generally motivated to be law abiding and the possibility that they themselves may face liability for their clients’ securities law violations only increases that motivation. Moreover, a single gatekeeper may guard the entry ways to the securities industry for scores of existing and potential clients. A law-abiding gatekeeper may be able to stop multiple bad actors and prevent violations in multiple transactions before they ever make it into the securities industry—which maximizes our law enforcement effectiveness.

The good news—the white collar crowd is deterrable. The bad news—scandals keep happening. Which causes one to wonder; when it comes to fraud, why do the white collar types do what they do? Now, just to ask the question makes me a little nervous. As a recovering litigator, I know to avoid the “why” questions. As a law enforcer, I know I am not required to prove the “whys”, as opposed to the related issue of intent. And as a person with a few decades of life behind me, I know that when we do figure out the “whys” they often look nutty—especially after the fact.

But let’s think about the “why” question for a few minutes. If our only choice were to starve or steal, most of us would steal. However, for the people I’m talking about, starving is generally not a problem, and stealing not their only option. They are, by and large, exceptionally smart. Some of

them have been called “the smartest guys in the room”—and that may well have been true. They have been very well educated. They have been raised in relative economic comfort and in relatively functional families. Certainly, by the time of the fraudulent conduct, they are more often than not enjoying a level of economic comfort or wealth that many of us can barely imagine. They are often pillars of their communities and professionally well-regarded. And, while it isn’t always easy to know the details of someone’s private life, it appears that even on the non-monetary front, these individuals have lives with many pluses. They have, in short, an abundance of riches. And they put them all at risk. Why?

To draw on a real example from a few years back: why does the wealthy head of a major investment bank give confidential stock tips to his exotic dancer friend?⁵ With everything else wrong with his conduct, did he have to add insider trading to the mix? The “whys” from the current scandals are perhaps less dramatic but equally puzzling. Why, when you have everything, do you risk everything by tinkering with the company books? Why, when your company will pay you anything, do you pretend personal expenses are business expenses and run them through the company? Why, when everyone knows there are ups and downs in the life of a company, and in the life of an economy, do you do everything in your power to lie your way into an illusion that the only direction is up?

To be sure, there are some immediate and obvious answers to the why question; to meet the numbers. To beat the street. It’s a one time problem, with this one time fix. It will save the company. It’s a close question. I won’t get caught.

Let us look behind the obvious for a moment to explore the possibility of some other, additional reasons. I urge caution. I learned a long time ago that sometimes the obvious answer is the answer. As Sigmund Freud once said, “sometimes a cigar is just a cigar.”⁶ With that caveat, let’s think again about the question.

I submit that among some of the deeper, underlying reasons are ones of culture. In our culture, we value talent—especially what I think of as practical smarts. We especially value it in combination with money or power or both. And that is neither surprising nor bad. Indeed, the success of a capitalist democracy depends on it. In his State of the Union address this year, President Bush said he wanted a population that was educated,

5. *In re* Sec. Exch. Comm’n, Court Enters Final Judgment Against James J. McDermott & Kathryn B. Gannon SEC Bars McDermott from the Securities Industry, Litigation Release No. 19250 (June 7, 2005), available at <http://www.sec.gov/litigation/litreleases/lr19250.htm> (final judgment entered against former Chairman and Chief Executive Officer of Keefe, Bruyette & Woods, Inc., for providing material non-public information regarding merger transactions to Kathryn B. Gannon, (a.k.a. “Marilyn Star”) a former actress in adult films).

6. Brainyquote.com, Sigmund Freud Quotes, <http://www.brainyquote.com/quotes/quotes/s/sigmundfre125397.html> (last visited June 30, 2006).

hardworking and ambitious.⁷ Where would we be if we didn't? This country's proud history and hundreds and hundreds and hundreds of family success stories—poor immigrant in one generation and well into the mainstream a generation later—depends on it. Many of those success stories find their roots here in Brooklyn. Our record of innovation and expansion—the car, the assembly line, the light bulb, the railroad—depends on it. We need smart people working hard to make the country a success. To do that, we need to value and reward them.

To my mind, Benjamin Franklin is the quintessential American success story. Indeed, he was such a huge success and was so influential in the success of this nation that America celebrated his 300th birthday in January 2006. Franklin was born in Massachusetts, the 15th child of a Boston candle maker. Not only was he a writer, scientist, inventor and statesman, he was a great entrepreneur. Over the course of his life he amassed a fortune. He had brains, ambition, a limitless capacity for work—he had, in short, everything a new country needed and everything we still value.

At some point during his life, this Founding Father articulated a list of thirteen virtues to which his descendants should aspire. They are: Temperance, Silence, Order, Resolution, Frugality, Industry, Sincerity, Justice, Moderation, Cleanliness, Tranquility, Chastity and Humility. You may find the fact that the list includes thirteen items a bit peculiar; I know I did. But Franklin explains that: “My list of virtues contained at first but twelve; but a Quaker friend having kindly informed me that I was generally thought proud; that my pride showed itself frequently in conversation; that I was not content with being in the right when discussing any point, but was overbearing, and rather insolent, of which he convinced me by mentioning several instances; I determined endeavoring to cure myself, if I could, of this vice or folly among the rest, and I added Humility In reality, there is, perhaps, no one of our natural passions so hard to subdue as pride. Disguise it, struggle with it, beat it down, stifle it, mortify it as much as one pleases, it is still alive, and will every now and then peep out and show itself; . . . for, even if I could conceive that I have completely overcome it, I should probably be proud of my humility.”⁸

Now another thing about Franklin's list—intelligence, wealth, success, and power nowhere appear. What is my point?—simply this, that intelligence, wealth, success and power are attributes and accomplishments. And for those of us possessed of these attributes or accomplishments—and I include everyone in this room in that number—the fact that we have those things doesn't mean we're virtuous, it means we're lucky. And when compared to the conditions of life for most of the people on this planet,

7. President George W. Bush, State of the Union Address (Jan. 31, 2006), *available at* <http://www.whitehouse.gov/stateoftheunion/2006/index.html>.

8. BENJAMIN FRANKLIN, *THE AUTOBIOGRAPHY OF BENJAMIN FRANKLIN* 97–98 (Nathan G. Goodman ed., New York Carlton House 1932) (1791).

these attributes and accomplishments are gifts, not something we necessarily earned or deserve. Don't get me wrong, having these great gifts doesn't mean we're not virtuous either. To be sure we can use our talents or gifts virtuously; and we love to see the gift of brains in combination with the virtues of, as the President would say, hard work and ambition, or as Franklin might say Resolution and Industry. Indeed, some would argue that having these gifts makes being virtuous easier. Franklin certainly thought so when he said "[It is] hard for an empty sack to stand upright."⁹

So what can we do? Maybe we can think about a few things to check some of the less attractive aspects of some of these attributes. We can think about, for example, competition. Competition is often a good thing. It builds friendships and character and, not to beat a dead horse, railroads. But it can run amok. The need to compete is one thing; the need to always be first is quite another. With Opening Day just around the corner, think for a moment about all those baseball players who are alleged to have used performance enhancing drugs. Now think of the names of those players. They are not the guys wavering on the cusp between the minor leagues and the majors. It's the stars, the guys whose places in the Hall of Fame are, or were, secure. You see the same kind of phenomenon played out over salaries in a venue closer to home—in law firms. In many firms you see people who are making more money than they ever dreamed of. And when they find out what they are making, they are usually delighted—until they learn that one of their colleagues is making a little bit more.

Second, perhaps by rewarding talent, we have managed to convey to the talented that they are deserving, rather than lucky, and that anything they want is their due. Put another way, while it is certainly good to be talented, being talented doesn't make you good. Someone once told me the only two groups of people who could consistently pass a polygraph while lying are psychotics and white collar defendants. Now that may be entirely false. But I think the fact that we even entertain the idea that it may be true is based on the fact that it sounds true. Psychotics live in a world where they are incapable of distinguishing truth from lies. White collar defendants seem to me to be in a continuous process of self-justification and spin. Indeed, it is not unusual to confront someone who has done something totally and profoundly illegal and have that person react with surprise, indignation or outrage. "Me—you think I violated the law, did something wrong!?" It's as if a constant refrain runs through their brain—I, one of the rich and smart, want this. Ergo, it must be good and right.

So what do we do about all this? First, and foremost, we confront the conduct. We enforce the law. We investigate the misconduct and impose meaningful sanctions. We fine. We use all our tools with a keen eye toward deterrence, as all of the sanctions and tools discussed today are designed

9. *Id.* at 212.

with deterrence in mind. We exploit the fact that this is a deterrable population and that the businesses we deal with are, by and large, legitimate, and their long term success depends on that legitimacy. Similarly, the people in these businesses are, by and large, law abiding, talented people whose personal success also depends on being law abiding.

But, at the risk of sounding like the secular equivalent of a sanctimonious twit, maybe we can do more. We can all try to do a better job of valuing virtue for its own sake—which is a whole lot harder to do than to say. I need only think about the grading system at my son's school. For some years now the school has labored to recognize effort in addition to achievement. All courses have grades for achievement, A, B, C, D, F; and all courses have grades for effort, 5, 4, 3, 2, 1. There is an honor roll for achievement grades and an equally prominent, featured honor roll for effort grades. And yet ask any kid which is better—an A with an effort grade of 1 or a B with an effort grade of 5 and they will go for the A. All of them, without hesitation.

Perhaps more success can be achieved if we focus on recognizing that we are human and we are capable, no matter how talented, of screwing up. Remember Franklin's remarks about his capacity for pride—and his recognition that he could probably find a way to be proud about his humility. Because so many things come easily for the smart and talented, it is probably worth finding ways to remind ourselves what Franklin knew—it's hard work to be virtuous and ethical and it's not going to happen by accident.

We can teach ethics in professional schools and we can train ourselves to ask, in a business setting, is this right? Who are we helping? Who are we hurting? Just as we are now asking, I hope, what are the compliance challenges with rolling out this new product, we can ask what are the ethical and fairness issues?

Above all, we can try to be better at whatever it is we do—and I came across a remarkable example of how well this can work. Last June I happened to read a front page article in the Wall Street Journal about medical malpractice insurance premiums.¹⁰ The article reported that premiums are going up except for one group of doctors—anesthesiologists. The bulk of the article explored why anesthesiologists' premiums were not only not going up, but were going down. Turns out their premiums are going down not because of especially effective lobbying efforts for tort reform or very clever negotiation with hospitals and others to share costs and liability. Instead, some number of years ago anesthesiologists decided to be better anesthesiologists. They spent time, money and attention at figuring out what was going wrong and how to catch, prevent, avoid, and

10. Joseph T. Hallinan, *Heal Thyself: Once Seen as Risky, One Group Of Doctors Changes its Ways*, WALL ST. J., June 21, 2005, at A1.

mitigate problems. They invested in research. They invested in education. And in that process they became better anesthesiologists. And their premiums went down. For the doctors, I know they're happy to have lower premiums but I hope they are even more thrilled, as I know their patients are, to have fewer problems.

Not to put too fine a point on it, but that last story reflects my very sincere hope that not only do those in the securities industry seek to avoid enforcement issues, but that they do so for the right reasons—that is, because it is the right way to treat investors and the right way to sustain the industry that provides their livelihoods. And I think I'll end with the explicit recognition that to achieve that goal, we in law enforcement have a big responsibility too. We too must aspire to doing the right thing.

For most of my professional career I have carted around with me a copy of an old speech. It's reasonably short and I read it often. It looks like it was typed on a manual typewriter, courier typeface (probably pica), and it may even be a copy of carbon copy on onion skin (does anyone here who is a current law student have any idea what I'm talking about?). The contents reflect a variety of biases common to its time, including, about the role of women. But despite all of this, I think it has quite a bit to say to many of us.

The speech was delivered sixty-six years ago, on April 1, 1940, by then-Attorney General of the United States, and later Supreme Court Justice, Robert H. Jackson, to the Second Annual Conference of United States Attorneys. There was a heck of a lot going on then at the federal law enforcement level and plenty of things to talk about. We were, for example, in the midst of a World War that our nation would soon be joining. But what Jackson chose to talk about was fairness and character. He said, "It would probably be within the range of that exaggeration permitted in Washington to say that assembled in this room is one of the most powerful peace-time forces known to our country. The prosecutor has more control over life, liberty and reputation than any other person in America Nothing better can come out of this meeting of law enforcement officers than a rededication to the spirit of fair play and decency that should animate the federal prosecutor. Your positions are of such independence and importance that while you are being diligent, strict, and vigorous in law enforcement you can also afford to be just The qualities of a good prosecutor are as elusive and as impossible to define as those which mark a gentleman. And those who need to be told would not understand it anyway. A sensitivity to fair play and sportsmanship is perhaps the best protection against the abuse of power, and the citizen's safety lies in the prosecutor who tempers zeal with human kindness, who seeks truth and not victims,

who serves the law and not factional purposes, and who approaches his task with humility.”¹¹

What Justice Jackson describes is a model to which I think all of us in law enforcement should aspire and, if we ever need to see that model in practice, we need look no further than Irving Milton Pollack, Brooklyn Law School, Class of 1942.

Thank you very much.

11. Robert H. Jackson, *The Federal Prosecutor*, 24 J. AM. JUDICATURE SOC’Y 18, 18–20 (1940), available at <http://www.roberthjackson.org/Man/theman2-7-6-1/>.