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IN MEMORIAM

HARVEY GOLDSCHMID: THE SCHOLAR AS REALISTIC REFORMER

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Harvey Goldschmid was a Renaissance Man—extraordinary teacher, far-sighted public servant, skillful negotiator, and corporate statesman. But sometimes, less attention is given to his career as a legal scholar. Here too, however, his work has had impact and will last. Let me focus briefly on two examples.

At the request of his Columbia colleague and American Law Institute (ALI) Executive Director, Herbert Wechsler, Harvey Goldschmid drafted the original memorandum that set in motion a major project by the ALI to codify both the legal rules on fiduciary duties and the best practices in corporate governance in a Restatement-like format. The eventual upshot of this effort was a significant achievement for the ALI: *Principles of Corporate Governance: Analysis and Recommendations.*[1] But its gestation took over a decade of controversy and hard work. Law reform, as Herbert Wechsler liked to say, was "not for the short-winded." This delay was in part because the topic was complex and the world was changing, but more because many critics and opponents sought to stop the project dead in its tracks. They knew that ALI Restatements were influential, and they feared (correctly) that the ALI could not be lobbied in the same backroom style as corporate lobbyists used in dealing with state legislatures. Rather than objecting simply to the specifics of what the ALI's Reporters proposed, these critics challenged the ALI's right to speak or address topics that were not purely legal in nature. Business groups retained counsel, and some ALI members took on the questionable dual roles of counsel to a client and voting (and theoretically disinterested) ALI member.

As the Reporter for Litigation Remedies for this project, I had a ringside seat and saw Harvey at his best and most stalwart. He became the Deputy Chief Reporter (with Melvin Eisenberg of Berkeley handling the Chief Reporter's duties). Harvey took for himself the critical role of drafting the standards for the duty of care and the business judgment rule. At every step, his opponents sought delay and argued that the complexity of the topic precluded any black-letter articulation of the rule. Characteristically, Harvey persisted (through

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1. Principles of Corporate Governance: Analysis and Recommendations (Am. Law Inst. 1992).

more drafts than I can now remember), and eventually the product of his labors—section 4.01 of the *Principles of Corporate Governance*—was approved by the ALI and has become the most cited provision of the *Principles*.

Notwithstanding the complexity of the topic, section 4.01 is both admirably clear and subtle. It conditions the business judgment rule on a requirement that the officer or director seeking to invoke it "is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances."[2] There are nuances in those words (as this is an objective standard coupled with a subjective requirement of good faith). It contains both a "standard of conduct" (i.e., a standard telling the actor how to behave) and a "standard of appellate review" (a standard telling courts how to enforce the rule).[3] Thus, it was at once aspirational, exhortative, and realistic. Although Professor Goldschmid was at points forced to compromise, he did so only marginally and grudgingly.

In a similar effort to ensure that the costs of the rule did not exceed its benefits, he and I agreed on a compromise strategy as to how it was to be enforced. I had long believed that the historic role of the derivative action was to enforce the duty of loyalty, not the duty of care. Duty-of-care cases could often threaten astronomic damages and thus could create an excessive incentive for plaintiffs to bring cases that might be weak on these merits. Also, corporate actors might feel compelled to settle, regardless of the merits, in a way that trivialized the operative legal standards. In my sections, we proposed (and the ALI agreed) that shareholders could adopt a charter amendment severely reducing the damages for a breach of the duty of care (subject to various limitations).[4] Originally, this idea of charter-imposed limitations on liability seemed novel, and many doubted that it would be followed. But then, in the wake of the Delaware Supreme Court's decision in *Smith v. Van Gorkom*, a decision that imposed significant damages on independent directors for breach of the duty of care,[5] a crisis arose. Directors' and officers' insurance policies were canceled, and some panicked outside directors actually resigned for fear of liability. This crisis necessitated a response from Delaware, and a drafting committee, after considering a variety of options, turned to our charter amendment proposal. Within months after our proposal was first published, Delaware enacted a form of it (with some questionable modifications) as section

2. Id. § 4.01(c)(2).

3. For a fuller explanation of this distinction, see Melvin Aron Eisenberg, The Divergence of Standards of Conduct and Standards of Review in Corporate Law, 62 Fordham L. Rev. 437 (1993).

4. See Principles of Corporate Governance: Analysis and Recommendations at § 7.19 (providing limitations on damages for violations of duty of care).

5. 488 A.2d 858, 893 (Del. 1985). Special exceptions were carved out for "knowing and culpable violations of law," "conscious disregard" of duties where serious injury was threatened to the corporation, and a continuing "abdication of duty." Principles of Corporate Governance: Analysis and Recommendations at § 7.19. But the ceiling would clearly have applied to the facts of *Smith v. Van Gorkom*.

102(b)(7) of the Delaware General Corporation Law.[6] By 1987, a majority of the states had followed, with at least some states adopting provisions more closely modeled after the ALI version.[7] Within a few more years, the vast majority of public corporations exercised their new power to adopt such a charter provision, and institutional shareholders voted for them in overwhelming numbers. Rarely has an academic proposal received such near-universal acceptance.[8] In my judgment, this broad acceptance was because the integrated ALI proposal gave the choice to shareholders and did not seek to outflank them.[9]

A second example that similarly shows Professor Goldschmid's ability to reach a well-balanced compromise (while also withstanding overbearing pressure) is Regulation FD.[10] This Securities and Exchange Commission (SEC) rule, drafted under his supervision while he was the SEC's General Counsel, prohibited selective disclosure without attempting to characterize it as insider trading. In *Dirks v. SEC*, the Commission had suffered a stinging defeat, as the Supreme Court had imposed a fiduciary breach requirement on the law of insider trading.[11] In its wake, investment banks developed a very lucrative practice under which their securities analysts regularly tipped institutional investors as to corporate earnings and other material developments, often just a day (or even hours) before the public release of this same information. Potentially, the SEC could have responded with a rule that deemed such communications and trading to be unlawful insider trading (even though no "personal benefit" was paid to the tippee, who may have believed such advance disclosure was in the corporation's interests). But such a strategy would have placed the SEC on a collision course with the Supreme Court and risked

6. The ALI proposal basically enabled shareholders to place a ceiling on director and officer liability for duty of care breaches equal to such person's annual compensation from the corporation. This was intended to permit plaintiffs to recover more from the CEO and other "inside" directors (who might receive millions in salary and options), while only a modest amount from outside directors. The rationale was that CEOs were unlikely to be deterred from serving by the threat of some liability, while outside directors might be. Although Delaware adopted the ALI charter provision approach, it authorized a charter provision that simply eliminated monetary liability for breach of the duty of care (absent some special exceptions, such as knowing illegality). Del. Code. Ann. tit. 8, § 102(b)(7) (2015).

7. Some thirty-one states adopted legislation eliminating or placing a ceiling on duty of care liability between 1985 and 1987. See ALI, supra note 1, § 7.19 reporter's note 4, Virginia followed the ALI approach by placing a ceiling on such liability, which ceiling looked in part to the annual compensation received from the corporation. See Va. Code Ann. § 13.1-692.1 (2015).

8. The only ALI proposals that I can recall receiving greater support would be the ALI's Model Penal Code (drafted by Professor Wechsler).

9. Delaware had been considering the alternative of authorizing corporate indemnification of the recovery (judgment or settlement) in a duty of care action. But that approach had a number of faults, including that it might encourage the bringing of more such duty of care actions in the hopes of passing the costs of settlement on to the corporation (and its shareholders).

10. 17 C.F.R. §§ 243.100–.103 (2015). This rule was adopted in 2000. See Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,721 (Aug. 24, 2000) (codified at 17 C.F.R. §§ 243.100–.103).

11. 463 U.S. 646, 664 (1983).

reversal. Wisely, Harvey Goldschmid fashioned a compromise solution: a non-fraud rule that made selective disclosure effectively a venial sin. Probably no SEC rule in the modern era was more vehemently resisted by the industry (or more fervently supported by ordinary investors). Now, fifteen years later, one must conclude that his compromise worked: Selective disclosure is no longer an institutionalized practice (and the market remains efficient). The rule was also part of an integrated package of insider-trading reforms that in some cases expanded liability and in other cases created a safe harbor that allowed corporate officials to arrange their affairs so that they could avoid any risk of involvement in insider trading.[12] To a considerable degree, Professor Goldschmid thus shaped the modern law on insider trading.

Both these examples reveal Harvey Goldschmid's character, personality, and essential toughness. He fought fiercely contested battles and won against entrenched forces that rejected any reform. But his courage was tempered by realism and good judgment. Never reckless, he triumphed because he could marshal convincing support for an always reasonable position. That is how he should be remembered—tough, smart, willing to structure a balanced compromise, but committed to fairness.

12. At the same time as the SEC adopted Regulation FD, the SEC also adopted Rules 10b5-1 and 10b5-2. The latter rule expanded liability, effectively reversing United States v. Chestman, 947 F.2d 551 (2d Cir. 1991), see 17 C.F.R. § 240.10b5-2, while Rule 10b5-1 gave executives a safe harbor by which they could avoid any risk of liability if they gave full investment discretion to another person to trade for them. See id. § 240.10b5-1.