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State Enforcement: An Interview with Eliot Spitzer

By Jodi Misher Peikin and Stephen M. Juris

The corporate scandals of the past several years have shaken the investing public. In response, state attorneys general like New York's Eliot Spitzer have shown what state regulators can accomplish with an ambitious agenda, talented personnel, and the right statutory tools. With Attorney General Spitzer leading the charge, state attorneys general have played an increasingly active role in matters traditionally handled without state intrusion by the SEC and other federal regulators. This increased state activism has not been free of controversy. In a recent interview, we asked Spitzer about the causes and consequences of that activism and what the future holds. His answers, and the recent activities of his counterparts in other states, confirm that state attorneys general are in no hurry to return to the *status quo ante*. Like it or not, the states are here to stay.

Increased State Activism

The stimulus for this increased state activism is easy to discern. Spitzer believes that the SEC and other federal agencies are the ones that opened the door to state regulation: "Six years ago, these agencies were doing nothing … there really was a void." State regulators like Spitzer, California Attorney General Bill Lockyer, and Massachusetts Attorney General Tom Reilly have been more than happy to fill the perceived void.

The SEC Has 'Come to Life'

More recently, however, federal regulators have tried to reassert themselves. Spitzer noted that the SEC has "come to life" as of late, and to some extent, the numbers support this conclusion. The SEC commenced 639 enforcement actions in 2004, versus 503 in 2000. The 2000 figures hardly suggest that the SEC was taking a *laissez faire* approach even before the scandals of recent vintage, but for Spitzer they tell the larger story: "We now have got more activism there," he said.

Given this increased activism, some have wondered whether Attorney General Spitzer, and perhaps other state attorneys general, would once again take a back seat to federal authorities. *The New York Times* recently reported that Spitzer's office was prepared to "cede" its investigations of investment banks, mutual funds, and insurance companies to federal regulators. Spitzer's office quickly denied this, but conceded that increased activism by federal regulators meant that "it would be less likely that states would have to take the lead or act alone in confronting new problems." The *Times* issued a correction, leaving readers to speculate whether the pendulum would now swing back towards the SEC.

But Spitzer left us no doubt that he's still in business. While he views the SEC — the "rulemakers" — as a willing and important partner in his crusade against corporate malfeasance, he does not expect to change his approach to financial cases in the remaining 2 years of his term. He's been recruiting smart and able lawyers, many of whom are experienced prosecutors, and he intends to make the most of their talents. He'll continue to pursue tips brought to his office by whistleblowers like the ones that began the Merrill Lynch and Canary Capital Partners cases. To emphasize his point, he disclosed that his office had received three leads within 24 hours of our interview.

Other AGs Follow Suit

Other attorneys general also do not appear content to fade into the background. California Attorney General Bill Lockyer has announced his own mutual fund cases using powers granted to him for the first time last year by California's legislature. Massachusetts's attorney general recently announced the expansion of his own, separate investigation into insurance bidding practices. Their roles may evolve, but Spitzer and his counterparts are not retreating.

Coordination

What can practitioners and corporate America expect from all this? For one thing, complexity. State and federal regulators' overlapping jurisdiction, particularly in the securities arena, can lead to parallel and competing investigations, increasing the chances of inconsistency and imposing enhanced burdens on the corporations and individuals under investigation. For Spitzer, turf battles are not new. He noted that state and federal prosecutors competed over organized crime cases in the 1980s, and that state and federal prosecutors in New York have competed for years in areas of overlapping jurisdiction. The real issue is how state and federal authorities coordinate their efforts to make sure that resources are not wasted. Spitzer told us that he regularly consults with the SEC and will not interfere with ongoing federal investigations.

(The SEC to some extent also coordinates efforts with state regulators in investigations affecting national markets, according to SEC press releases.)

Although coordination is crucial to avoiding inconsistent law enforcement and imposing undue burdens, at present, such coordination and cooperation largely depends on informal consultation and goodwill. In September 2003, the SEC and North American Securities Administrators Association (NASAA) announced a joint initiative to address issues of cooperation between state and federal authorities, as well as the creation of a working group to study best practices and protocols for facilitating coordination. More than a year later, there still aren't any formal guidelines like the ones that govern antitrust and environmental regulation. Instead, Spitzer said the effectiveness of his cooperation with other agencies depends on good intentions and case-by-case considerations, one of the more important ones being "who you trust." Will Spitzer's goal of state-federal cooperation survive his tenure as attorney general, and do his colleagues in other states share his concerns? Without any formal, institutional protocol, practitioners and their clients can only hope that the key players will be able to hammer out a basic framework dictating which cases go to federal authorities and which cases remain with the states.

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Best intentions aside, it is only reasonable to expect that state and federal regulators will occasionally go separate ways to the detriment of those they have targeted. This happened in Spitzer's own December 2003 settlement with Alliance Capital Management, in which Alliance pledged to lower the fees it was charging to mutual fund customers. In a well-publicized rift, the SEC refused to incorporate a fee reduction into its own settlement, stating that the federal rulemaking process offered a better venue to address mutual fund fees than a stand-alone settlement. While Spitzer clearly recognizes the SEC's special responsibility for generating and enforcing consistent rules, "balkanization" may occur merely by having 50 different attorneys general involved in regulating national markets. These concerns have not been lost on Congress, which considered preemption legislation in 2003 that would have prevented state securities regulators from negotiating remedial settlements that impose obligations distinct from federal standards. The most recent version of that legislation was changed to require only a voluntary study on ways to improve state-federal coordination, but preemption remains a distinct possibility if concurrent enforcement creates a regulatory Tower of Babel.

Corporate America

For those convinced that the double pressure from federal and state regulators will smother corporate America, state-federal cooperation alone is no panacea. U.S. Chamber of Commerce President Tom Donohue has accused prosecutors like Spitzer of "criminalizing honest mistakes and legitimate accounting differences," as well as engaging in strong-arm tactics. Other critics, including law professor Leonard Orland, have taken aim at Spitzer's regulation of corporations with national and international operations, as well as Spitzer's October 2004 announcement that he could not negotiate with Marsh & McLennan, accused of bid-rigging and price-fixing, until that company changed its senior management – an announcement that was swiftly followed by the ouster of Marsh's CEO, Jeffrey W. Greenberg.

Answering the Critics

Spitzer says these criticisms miss the point. He sees this "pushback" from the business community as part of a larger failure to understand the extent of corporate malfeasance or to confront the systemic breaches of fiduciary duties revealed by his investigations. Although he professed a desire to avoid the briar patch of corporate governance, he was adamant that settlement with his office is not possible without a "partner" that understands the wrongfulness and consequences of its behavior. Apparently, he sees Marsh's decision to replace its CEO less as the result of prosecutorial armtwisting than as a necessary consequence of Marsh's decision to be a good corporate citizen.

The subtleties of this explanation may be lost on the corporations and executives that Spitzer has pursued over the past several years, but until he and his counterparts in other states perceive that companies like Marsh do "get it," they likely will not be pulling back.