The dynamics of financial regulation in the United States have been transformed by a series of investigations mounted by Eliot Spitzer, the State Attorney General of New York. Through the strategic use of his office, Spitzer has become one of the country’s most successful policy entrepreneurs. His success is linked to serendipitous confluence of three key factors: the diffused nature of regulatory authority in a federal system; the location of the state as the pre-eminent global financial centre; and the particularity of the New York State constitution, which offers little resistance to the vagaries of political ambition. The paper concludes that while Spitzer has highlighted serious structural problems and caused severe embarrassment, fundamental changes to market governance itself have been less evident.

This paper traces the structural and situational factors that have facilitated the rise to national prominence of the New York State Attorney General (SAG), Eliot Spitzer. Located at the intersection of economic and political governance in the pre-eminent global financial capital, Spitzer’s strategic application of state law in an attempt to force systemic changes in financial governance raises profound public policy questions. Where should regulatory authority over the securities market lie? Does the intervention of State Attorneys General, acting individually or on concert, enhance or militate against normative improvements in accountability mechanisms to counter the deleterious impact of structural problems? The focus is less on what
Spitzer has uncovered, which has been dealt with elsewhere. Rather it centers on what his concurrent investigations tell us about how the contested, contingent and interdependent nature of the national self-regulatory regime in the United States impacts on the battle for political control over the corporate form.

Explicating how the New York SAG has maximized the leverage provided by the innovative application of overlapping jurisdictional power has application far beyond the confines of the geographical boundaries of the state. It provides important evidence of how ambitious policy entrepreneurs within a federal system can exploit structural vulnerabilities to challenge the dominance of corporate power over regulatory design at national and international levels. The capacity of the national government and its agencies to enforce their writ over the governance of what are increasingly global markets is examined therefore with direct reference to the competing dynamic of federalism.

I argue that the leverage offered by exploiting this paradox provides policy entrepreneurs with exceptional traction to challenge hegemonic conceptions of neo-liberal market governance and the emergent power within it of corporate actors. As Gerber and Teske have pointed out in the context of U.S. regulatory politics, the “venue of primary policy execution itself becomes a central feature in explaining the logic of political influence on policymaking.” Spitzer’s intervention has been given such crucial significance because of his ability to exploit the concentration of the financial markets in New York City.

Based on an extensive interview conducted with Spitzer just after he announced his gubernatorial candidacy, the paper provides crucial insights into what drives one of the most pivotal regulatory actors in the United States. The following sections situate the institutional position of the New York SAG within the matrix of
political and economic power. First, I provide an example of how Eliot Spitzer has positioned his office as the arbiter of acceptable business leadership. This is achieved by detailing the investigation into the insurance industry, the most politically ambitious and controversial investigation mounted to date. Second, the constellation of forces that gives Spitzer unique leverage as a policy entrepreneur is traced. The power of the markets to frame and emasculate policy responses at the national level is then examined with reference to the literatures on regulatory change and federalism. The final section examines the implications of Spitzer’s capacity to exploit the gaps in the regulatory framework both in terms of capturing and reconfiguring the reform agenda.

INSURING AGAINST FAILURE

On 14 March 2005, one of the most powerful dynasties in the American insurance industry imploded. Maurice Greenberg, the chief executive of American International Group (AIG), the largest and most influential insurance group in the world, was forced to resign over allegations that the group had used a complex re-insurance deal to inflate its earnings. Greenberg’s resignation followed the forced departure of his son, Jeffrey, from the world’s largest insurance brokerage, Marsh and McLennan. A third son, Evan, who controls Ace, an influential insurer based in the Bahamas, has received subpoenas from the widening investigation into abusive practices in the industry.

The defenestration of the Greenberg family comes despite complaints in February 2005 by its patriarch that regulators were “turning foot faults into murder charges.” The charge was directed at Eliot Spitzer, the combative SAG of New
York. Spitzer had launched the public investigation the previous October with a subpoena asking the industry’s most powerful players if their business models were predicated on the payment of contingent commissions. Those inquiries have also ensnared the Chicago-based AON. Ten days before Maurice Greenberg’s departure it had provided $190 million to regulators in a settlement brokered by the New York SAG, in conjunction with his counterparts in Connecticut and Illinois. AON’s decision to capitulate rather than fight the charges was linked, in turn, to the decision by Marsh and McLennan to settle its litigation with Spitzer for $850 million on 30 January.⁸

Spitzer had argued with what has become customary dramatic verve that the insurance companies were engaging in “the same kind of cartel-like behavior seen in organized crime.”⁹ As the leading global brokerage, Marsh and McLennan, was viewed as the most egregious benefactor of how “contingent commissions” could be used to steer underwriting business. The corporation and its business methods had already come to the Spitzer’s attention through the involvement of two of its subsidiaries in previous unrelated scandals linked to financial intermediary failure. Putnam Associates had been embroiled in the investigations into the governance of the mutual fund industry. Mercer Consulting had been involved in the ongoing disputes over the compensation package offered to the former chairman of the New York Stock Exchange, which is now before the New York State court system. By the time Spitzer turned his attention to the insurance industry, it was clear his patience with the parent corporation was tested to its limits. He complained when announcing his suit that “Greenberg was unbelievable and the leadership of that company [Marsh and McLennan] was not a leadership I could talk to.”¹⁰ The Marsh board acceded to the warning. It sacked its chief executive before entering final settlement talks. Once
Maurice Greenberg announced that he would sever all ties with AIG over the allegations of accounting irregularities, Spitzer released a terse statement. “The board and current management of the company are now cooperating with this investigation. Based upon these efforts, and based upon our knowledge to date, we believe that a civil resolution with the corporation will ultimately be achievable.” The message was clear. Spitzer was determined to use his office to ensure not only compliance but also regime change, a highly questionable position for an elected politician to take.

Although no admission of liability accompanied the insurance settlements, in each previous case the corporation involved apologized. Furthermore, they announced what the SAG determined were sweeping changes to their internal governance. These included the adaptation of a written code of conduct. The money will be used to compensate policyholders. This marks a distinct change in strategy. Earlier punitive fine-based forms of corporate punishment had served primarily to enrich state treasuries. It is an indication that Spitzer’s office has become acutely attuned to the fact that the proactive search for corporate malfeasance now faces more critical questioning of underlying purpose.

Critics claim he is a populist cast in the mold of Robespierre, who has unleashed chaos and contributed to a dangerous “Balkanization” of financial control mechanisms in the pursuit of political ambition. His methods, particularly in relation to the Greenberg dynasty, have led the Wall Street Journal to condemn him as “the Lord High New York Executioner.” On the other hand, without his intervention the structural defects in Wall Street analyst research, shortfalls in the governance of the New York Stock Exchange, and the corruption in the insurance industry would arguably remain publicly undetected by an overarching regulatory system that has demonstrably and repeatedly failed to inculcate restraint. As such
Spitzer has become an effective, if controversial, proponent of what Zimmerman has termed the “innovation-diffusion” model of SAG activism.¹⁴

The trajectory of the insurance probe followed the distinct pattern patented by the SAG in his investigation into prior deficiencies in the governance of financial markets. The case for reform was built on a public interest defense based on the deleterious consequences of an erosion of fiduciary trust. Probity is the most valuable commodity for the financial intermediaries of Wall Street; any question of its dissipation is an institutional Achilles Heel. Equipped with this knowledge, Spitzer actively exploited the chink in Wall’s Street metaphorical “quilted armor of lawyer-spun sophistries.”¹⁵

Spitzer has fused the legal and political aspects of his office to force changes on the governance of key intermediating forces operating within United States capital markets. While federal agencies, including the Securities and Exchange Commission, played pivotal roles in highlighting deficiencies in the accounting practices engaged in by AIG, the New York (SAG’s office has captured the agenda through the adroit use of public relations.¹⁶ In order to assess how and why he has acquired such prominence, it is necessary to map the geo-political contours of his powerbase.

LOCATION, LOCATION, LOCATION

The scale of the malfeasance and misfeasance in the capital markets in New York has provided the SAG with an extraordinary capacity to exercise regulatory leadership. Spitzer maintains that any suggestion that he is hostile to the operation of free markets misses the point. He argues that his intervention is predicated on a belief that effective markets cannot be sustained without robust regulatory oversight of
existing standards. “I say repeatedly to Chief Executive Officers that you would have been better served to have adopted the gradual process of reform. It would have saved you from the gross excesses or the pain that you are going through right now.”

Just as importantly, integrity and transparency, the key themes associated with his myriad investigations into abuses of fiduciary duty on Wall Street, have allowed the Attorney General to exorcise prior doubts about his own.

Despite undoubted legal skill and proven ingenuity in the use of strategic prosecution to change public policy, Spitzer’s campaign for the office of New York SAG was initially regarded with suspicion. Defeated in his first attempt in 1994, he was elected by a slender margin four years later. The distrust about his ambition, and the lengths he was prepared to go to achieve it, were exemplified by a campaign financing scandal. Reluctantly endorsing the candidate in 1998, the New York Times described his response to questions about the multi-million dollar parental support provided to his campaign as evasive and dishonest.

Just as the events of September 11 transformed a lackluster presidency, the implosion of corporate integrity and the failure of the regulatory agencies to tackle it, invigorated Spitzer’s tenure as SAG. As the technology bubble collapsed leaving behind the detritus of a boom fuelled by hubris, investor anger was accompanied by public inaction from self-regulatory and federal organizations. The campaign for enhanced accountability and fiduciary duty, which now form the basis for Spitzer’s strategy to win the state gubernatorial contest in 2006, were forged in the exploitation of this failure. By building on a case already before an industry arbitration panel involving defects in the research coverage provided by Merrill Lynch to a wealthy New York gynecologist, Spitzer’s legal research team found the issue. The mechanism used to exploit it was the Martin Act, a New York State statute which
gives the SAG almost unlimited rights to secure subpoena evidence in relation to potential fraud in the selling of securities.\textsuperscript{21}

The innovative use of the Martin Act demonstrates the efficacy of the statute as an enforcement tool. Spitzer attributes his success to the “brushing off the accumulated dust of an old standard that has fallen out of favor.”\textsuperscript{22} What differentiates Spitzer from other state and federal bodies charged with market oversight is not just the manner in which he has used the legislation to publicly name and shame his targets. Rather it is the way in which the price for settlement incorporates a regulatory-imposed design that has the potential to become a new industry standard. This dynamic underpinned the enforced self-regulation component of a settlement with Merrill Lynch over conflicts of interest in the provision of research reports that catapulted Spitzer onto the national and international media stage.\textsuperscript{23}

The power of Spitzer’s mantra for structural change was authenticated by the publication of highly embarrassing emails, which appeared to show a pathological contempt among Wall Street professionals towards ordinary investors. Demonstrating that the research departments of premier securities houses manipulated corporate coverage for investment banking purposes was always a problematic assumption to prove until Spitzer’ s investigators discovered just how useful email records could be. Buried deep in the hard drives, the elusive proof of systemic abuse was revealed in the dyslexic boasting of research analysts. They maintained “buy” ratings while privately describing stock as “junk.” \textsuperscript{24} In taking the case against Merrill Lynch, Spitzer alleged that “research analysts were employed as “quasi-investment bankers for the companies at issue, often initiating, continuing and/or manipulating research coverage for the purpose of attracting and keeping investment banking clients.” \textsuperscript{25} It was not an
impediment to Spitzer that this fact was both well-documented and accepted within the literate financial community. He saw in the erosion of Chinese Walls a structural weakness that threatened the metaphorical “small investor” who relied, erroneously, on the truth of financial communications. The salience of the issue and the political traction it garnered was magnified precisely because the deepening securitization of the economy had brought ever increasing numbers of people into the stockholding fraternity.

Merrill Lynch’s acceptance of forced internal changes to the governance of its research department in exchange for abeyance of charges, which, if prosecuted to a conclusion, would have caused catastrophic reputational damage, created a template for wider systemic change.26 Once the corporation caved in, it was inevitable that a global settlement with other merchant banking institutions would have to be reached. For Gary Lynch, Vice Chairman of Credit Suisse First Boston and a former Director of Enforcement at the Securities and Exchange Commission, Spitzer simply out-maneuvered the federal regulators and forced them into the public arena: “At that point everyone [in the investment banking community] was saying “tell us what you want us to do”. What people hoped to avoid, which we didn’t avoid, was them saying: “No, we’re not going to do that we don’t want to do that. What we want to do is to have an investigation and fine you a whole lot of money”. 27

The eventual penalties in a global settlement, which encompassed all major investment banks, primary regulators and a consortium of SAGs led by Spitzer, went far beyond financial recompense to cash-strapped state chanceries. The forced publication of the results of that joint investigation, under Spitzer’s direct instruction, provided ammunition for class-action tort lawyers, whose capacity to have their case heard in either state or federal court was increased dramatically by their ability to
prove just cause. Despite a subsequent and significant rebuff to the Merrill Lynch plaintiffs in the federal court, an indication of the eventual cost to Wall Street of malfeasance is the fact that Citigroup, the largest financial services conglomerate, has set aside $4.95 billion to cover its litigation exposure.

By bringing the initial Merrill case and setting the agenda in relation to subsequent investigations into corporate abuse, Spitzer not only highlighted profound structural problems in the governance of the markets but also placed into play the contested limits of state and federal sovereignty. In the process he has transcended a political and industry response predicated primarily on the challenge of how to limit the discretion of individually culpable executives through the politics of symbolic reassurance. The capacity to alter the debate is linked to the specific circumstances of his powerbase. A senior compliance officer for a major investment bank, interviewed by the author in 2003 as Spitzer was negotiating a settlement with Merrill Lynch over tainted analyst research, encapsulates both the anger and grudging respect which the New York SAG generates in equal measure.

To be candid about it while the states have been bringing actions for 60 years the presence and amount of publicity they got was always somewhat contained. They were viewed as having a useful purpose but they never had celebrity status. Spitzer’s case has brought glory and publicity and all this attention to state regulators, not to mention a whole lot of money to state treasuries. I think state regulators are sitting across all of the United States now saying “Wow! We have real power, we have real authority. We have a way to be very profitable. We need to flex our muscles even more in the future.” This tension is going to grow. At some stage something is going to give.
From a policy perspective the increased regulatory activism by SAGs, acting individually or in concert, raise the most profound questions about the efficacy of regulatory governance in the United States. The traditional privileging of state jurisdiction over the governance of corporations creates a competing and at times contradictory dynamic to the ambitions of federal regulation. It is precisely this dynamic that many in the securities industry are now attempting to redress by curtailing the capacity of the SAGs to intervene even if it means accepting the remit of a reinforced, federal regulator.

An indication of the changing dynamic is the passage of the federal Class Action Fairness Act 2005, a tort-reform measure that is designed to limit the capacity of states to hear class-action suits with an aggregate value of over $5 million. The passage of the act is a victory for the business lobby. Although the argument was presented as an efficacious way to ensure federal oversight over interstate commerce, the law removes major tort cases from the state arena as a mechanism to reduce the kind of punitive damages seen in recent tobacco litigation.

STATE-FEDERAL RELATIONS AND THE GOVERNANCE OF FINANCIAL MARKETS

The initial target of industry ire over the politicization of the SAG office, Michael Moore, the Mississippi SAG and prime instigator of the multi-billion dollar attack on tobacco, has now been supplanted by Spitzer. His assault on demonstrable cases of industry and federal regulatory failure are underpinned by a coherent, if contested, policy imperative to challenge the efficacy of the existing regulatory regime. By highlighting structural failings, his campaign has proved instrumental in
prompting the most radical reassessment of the role that regulators should play in the policing of the markets since the securities legislation introduced by the New Deal reforms in the 1930s.

Attorney General Spitzer professes that his relationship with Wall Street financiers is one of mutual fascination and incomprehension. He is perplexed by what he sees as their moral relativism. They, in contrast, fail to understand what drives the Attorney General is more than ambition. Spitzer, of course, is too canny not to accept that ambition plays a part. He answered this author’s question of what drives him with the retort that “the same thing that drives a writer to win a Pulitzer.”

Behind the jocularity, Spitzer made a very serious point: “I went to dinner recently with a group of Wall Street Chief Executives. I explained to them that Merrill Lynch alone has a compliance department bigger than my entire operation. I advised them that unless there were profound changes, they would be better advised to shut it down, invest the money in a contingency fund where at least it could earn interest and use it to pay the fines for non-compliance.”

This, suggests Spitzer, is the major untreated cancer destroying the vitality of American capitalism and against which neither the corporations, the self-regulatory industries nor the federal architecture have provided an antidote. “One of the things that I enjoy about going to Washington is the opportunity of testifying, chapter after chapter, that self-regulation has failed. What is it to be replaced with? I’m not sure.”

The overarching regime, in Spitzer’s view, fails to address in a systemic manner the paradigmatic power of market professionals. “The investment banks are at the vortex of all of this [malfeasance],” he claims, arguing that “the risk-reward calculus is so clearly out of kilter with ethical behavior. Yet no-one thought the paradigm needed to
change. The solution is not more regulation but more innovative application of existing enforcement strategies.”

While debate has been subsumed occasionally by discussion of the political ambitions of the messenger, the central argument advanced here is that differentiating the strategic pursuit of change from the tactical quest for office offers opportunities to understand not only the causes of the malaise but also why effective battle over corporate control has been so elusive. The tension over the governance of the financial markets is given tangible expression because of the rhetorical framing of “New Federalism”, which reconfigures in ideational terms the relationship between Washington and state capitals in much social and economic regulation. This delegation of regulatory authority occurred in response to what amounted to “a crisis of legalism and command” The political response to the overreach in the federal regulatory environment changed the power balance in state-federal relations in profound ways. As the national government gradually withdrew from the regulatory playing field, the space opened for policy entrepreneurs to play pivotal roles in the regulation of social and economic markets. Their relative power depended on the level of interstate competition, degree of residual federal power and its willingness to exercise it.

The institutionalization of deregulation created a cross-cutting ideological dynamic at national level which reduced the capacity of the federal government to exercise its privileged use of concurrent powers. The changes in the national regulatory regime were not accompanied by a revisiting of the intergovernmental settlement. In part this can be traced to the difficulty in pushing through complex and potentially destabilizing constitutional changes; in part to the fact that national policymakers did not factor into ideological imperatives how expanding state
oversight could facilitate, in the case of New York, the serendipitous confluence of ambition, powerbase and platform. Writing just as the bear market reared its head, Spitzer gave an early indication of how deregulation impacted on his legal philosophy.

Despite my initial skepticism, the day I awoke as Attorney General of New York, I had an epiphany - I suddenly recognized that the devolution of decision making from Washington to the States about how to enforce statutes or non statutory rights did not determine the substantive conclusion of those making decisions of the state level. Indeed, I now see this change as a tremendous opportunity for legal ingenuity and innovation on the part of state actors.  

Given the traditional concentration of the securities and wider financial services industries in New York, its state officials have always held the potential to exert extraordinary influence over the terms of the national debate on the control of capital markets. The use of this latent power had been honored more in breach than observance until Spitzer began his assault on the governance of the markets in the wake of the technology crash. As Spitzer acknowledges with a glint of satisfaction, the myopic fixation with the present in contemporary American politics gave him the flexibility to build “a coherent rationale under the political radar.”

Neither the securities industry nor state and national legislators gave due cognizance to how an assertive lawyer with political ambitions could use the latent power of “New Federalism” to revisit ground once trampled by Theodore Roosevelt and his cousin Franklin Delano, the towering figures of twentieth century New York politics. Both had also used state-initiated campaigns against patronage and cartels to forge national careers.
Through the utilization of pre-emptive investigative techniques, focused on high-profile targets, Spitzer has re-created a compelling narrative. It captures populist revulsion at the rash of corporate scandals and positions the narrator as the custodian of the reform tradition articulated in earlier battles to exert political control over corporate and vested political interests. Despite the fact that the Attorney General has yet to prosecute a case involving Wall Street malfeasance to judicial closure, a cult of personality has developed which business and political opponents alike have failed to deflate. Spitzer’s ability to drive the media discourse on corporate excess is further consolidated by the fact that New York plays host to some of the country’s most influential print publications. *The New York Times, The Wall Street Journal* and *The New Yorker* have provided copious amounts of largely positive copy in their news pages, a process which is facilitated by an adroit media management operation conducted out of the Attorney General’s Manhattan headquarters. Spitzer has also featured on the front cover of *Time* and *Newsweek*. In 2004 he picked up the “Person of the Year” accolade from the *Financial Times*. His capacity to capture the public zeitgeist was verified by a flattering *Vanity Fair* profile in which the Attorney General posed for the highly stylized portrait most commonly reserved in the magazine for Hollywood icons.43 The framing reflected the Attorney General’s own self-perception as a harbinger of light amid the gloom of a system that has lost moral authority.

The portrait evokes explicit comparison with the late American jurist Louis Brandeis, whose reputation was also built on confronting the danger of untrammeled corporate power. Whether Spitzer merits comparison with Brandeis, the progressive idealist or the propagandist with an unerring capacity to tack towards winning ground is very much an open question.44 What is unmistakable, however, is their common
determination to use the application of the law as a political weapon to force change far beyond the narrow remits of individual cases. The methods deployed and the consequences have amassed considerable opposition. Typical was the blistering attack launched by Thomas Donohue, the President of the U.S. Chamber of Commerce. In a New Year press conference highlighting priorities for the coming twelve months, Donohue accused Spitzer of spectacular abuse of office.

He’s the investigator, the prosecutor, the judge, the jury and the executioner. Spitzer’s approach is to walk in and say, “Well, we’re going to make a deal, and you’re going to pay $600 million to the state and you’re going to get rid of this person and that person and if you don’t do it by tonight then I’m going to indict the company.” What does indict the company mean? It means they’re going to put you out of business. It’s the most egregious and unacceptable form of intimidation that we have seen in this country in modern time.45

During an address to the National Press Club on 31 January 2004, Spitzer revealed in his notoriety. Recounting how a lawyer representing an investment bank told him “Eliot, be careful we have powerful friends.” Spitzer scathingly commented: “I had no choice but to file the lawsuit. I mean what was I going to do at that point? Should I back down and say: ‘Oh, I didn’t know you had powerful friends. Now you tell me. If you only had told me that last week we wouldn’t be here.’”46

While Spitzer claims modesty prevents overt comparison with his political icons, he maintains that, like them, he is being vilified by vested interests: “I operate only in the world of malfeasance and the capacity of my office to intervene involves a predicate of illegality. There has been so much misfeasance that I haven’t worried about it. I think if we ever get to the point where we only had to deal with misfeasance we would have done quite well.”47
More problematic for state-federal relations is the fact that in the process Spitzer has launched a direct challenge to the authority of the SEC and self-regulatory organizations. This takes us to the root of Spitzer’s stated reform agenda. For Spitzer, the central problem is how to ensure that adequate controls are placed on the operation of financial intermediaries, whose capacity to game the regulatory system is based on rational decision-making processes that calculate the net benefit of non-compliance.

According to Spitzer, the malfeasance progressively uncovered demonstrates intractable and insurmountable problems associated with the policy preferences of the national regulatory regime to privilege self-regulation. He argues that an “insidious form of industry capture,” linked to the cultural denigration of the regulatory profession, represents the most important causal mechanism driving control failures. “The whole idea of self-regulation should be put in a box labeled ‘great idea that never worked’ because the role of these industry associations became primarily the role of rolling back reform ideas. The excesses have demonstrated serious flaws in the paradigm. I am not convinced that it can ever work.”

This activism has led to profound disagreements with leading congressional legislators, including Rep. Michael Oxley (R-OH), co-sponsor along with Sen. Paul Sarbanes (D-MD) of the ostensibly stringent corporate liability legislation introduced in the aftermath of the collapse of WorldCom. At congressional hearings in Washington, Rep. Oxley made clear his antipathy to Spitzer. “Grandstanding by ambitious and publicity-hungry political officials will not lead to healthy and responsible securities markets.” Spitzer retorted in testimony to the Senate Banking Committee: “I believe that Congress and the federal government cannot have it both ways. If Congress and the Executive Branch decide to curtail federal oversight of
areas such as securities, they must recognize it is the responsibility of state securities
regulators such as myself to step in and protect the investing public.”

The role of government, both state and federal, in regulating and defining the
parameters of appropriate business standards remains a critical unresolved issue.
Noting that regulators are witnessing the beginning of a sustained counter-offensive
by business to delineate the range and extent of internal and external control
mechanisms, Spitzer has complained that “there has been a catastrophic failure to
adhere to even basic conceptions of honest dealings and fiduciary duty in every sector
my Office has looked at.” The problem is not a new one but rather the
contemporary manifestation of a perennial question: Can the market instill credible
ethical restraint or can transparency and integrity, which are integral to confidence, be
achieved only through the intervention of government. If it is the latter, can this be
achieved by the federal government acting alone? Does Spitzer’s activism help or
hinder that process? To answer these questions it is necessary to delineate further the
dynamics of financial regulation within the unique context of a federal system.

MAPPING THE CHANGING TERRAIN OF FINANCIAL GOVERNANCE

The notoriety and traction Spitzer has achieved are linked, therefore, directly
to the paradox of a collection of unitary states operating within a contested federal
structure. The particularity of the New York State constitution gives its Attorney
General the institutional capacity to take pre-emptive action to protect what the
incumbent perceives to be the public interest. In contrast to New Jersey, where
executive power resides in the hands of the Governor alone, there are limited
gubernatorial or legislative restraints on Spitzer’s capacity to initiate litigation
irrespective of the will of other policy actors at state or national level. Add to this mix Manhattan’s geo-economic importance as a global financial and media center, political ambition, the capacity to engineer punitive damages and headlines by setting the price for legal settlement, and public receptiveness to a socially constructed narrative based on defenestrating executive excess because of prior hubris. Seen from this perspective, the inordinate power held by Spitzer to influence the future trajectory of national financial regulatory policy comes into clear focus. In testimony to Congress in November 2004 in relation to fraud and anti-trust violations in the insurance industry, Spitzer declared unambiguously:

It is clear that the federal government’s hands-off policy with regard to insurance combined with uneven State-regulation has not entirely worked. There are too many gaps in regulation across the 50 states and many state regulators have not been sufficiently aggressive in terms of supervising this industry…At a minimum, federal involvement may be necessary to assure some basic standards of accountability on the part of insurance professionals.53

Spitzer was careful not to suggest that federal pre-emption was the answer. Rather his focus was on the lack of regulatory resolve, a discourse mechanism that neatly ensures the continued centrality of his investigative methods, ideological predispositions and wider political ambitions. In this there are significant further throwbacks to the juridical canon of Louis Brandeis. As early as 1926, Justice Brandeis proclaimed that “a single courageous state may, if its citizens choose, serve as a laboratory, and try social and economic experiments without risk to the rest of the country.”54 Nowhere is this resolve to provide a laboratory for economic engineering more apparent than in the strategic threatened prosecutions of corporations as entities
and the concomitant defenestration of the hubris that governed the administration of the New York Stock Exchange under the tenure of Dick Grasso.\textsuperscript{55}

In order to test the efficacy of Spitzer’s argument that radical redesign is both necessary and viable, it is essential to place into perspective the myriad pressures placed on the Securities and Exchange Commission by the dynamics of associational governance. Spitzer maintains that the corporate governance reforms advanced in response to that crisis serve a palliative purpose, treating the symptoms but not the cause. He is supportive of the Public Company Accounting Oversight and Investor Protection Act 2002 (Sarbanes-Oxley)\textsuperscript{56} but suggests its primary emphasis on only one part of the associational matrix -- the audit profession and corporate boards -- merely displaces the risk.\textsuperscript{57} For the New York SAG insufficient attention has been placed on the governance of other key intermediating forces.\textsuperscript{58} For Spitzer the primary problem with the legislation lies in its intellectual roots in “a culture of compliance and certification. There is increased individual liability but the focus is on form rather than substance.”

In the United States, this remains a critical issue. The capacity to critically determine juridical norms is based on the degree of clarity and political salience underpinning the legal framework. If laws and regulations are vague, or the detail left to regulatory bodies to negotiate with institutional actors given equal voice by the heterarchy of governance, particular intractable problems emerge. The dichotomy between appearance and reality in regulatory politics and the wider symbolic nature of law as a rhetorical device that is capable of manipulation through creative interpretation renders the governance of the financial markets particularly problematic.
The debate on how the reporting on internal controls should be viewed by regulators further demonstrates the inordinate endogenous pressures at the national level to construct a hollow shell that provides symbolic reassurance. There is a profound risk of reduced legal liability because of judicial or agency deference to an organizational response based on the institutionalization of “rational myth.”

The irony is that Spitzer’s trumpeting of his own reform agenda plays into this endogenous reality. The emphasis on written codes on conduct, without concomitant rigorous external monitoring to ensure that form overrides substance, can, in turn, subvert his stated policy imperatives. The critical importance of the Merrill Lynch settlement lay in the fact that the SAG drew up the terms of reference and played an oversight role by having a veto over the appointment of a compliance officer. The countervailing pressure from New York SAG serves to simultaneously add to the squeeze on SEC capability and offer a mechanism to deliver effective enforcement. By allowing what he had termed the organized crime cartel of the insurance industry to settle on much more favourable terms, Spitzer has devalued the importance of his office at precisely the moment he has gained most leverage.

CONCLUSION: DINING FOR ALBANY

There can be no doubt that Spitzer is an exceptionally adroit political animal. With a talent for public relations and backing from establishment figures within the New York Democrats, Spitzer launched a gubernatorial campaign at the Sheraton Hotel and Towers in Manhattan on 9 December 2004. In one stroke, Spitzer raised $3 million and positioned himself as heir apparent for the Democratic nomination. Basing his campaign strategy on a revitalization of the successful outreach beyond the Democrats core constituency that defined the Clintonian era, Spitzer averred that he...
would “take what’s best from liberalism and conservatism to solve problems in
practical ways.”60 Like other SAGs, Spitzer has skillfully used the office of attorney
general as a platform for the pursuit of higher political office. Since 1980, more than
40 per cent of those holding the position have run for higher office. Nor is the method
deployed by Spitzer to force change, through the strategic application of state law,
particularly innovative. As noted above, the increased regulatory activism of SAGs
can be traced back to the scaling back of federal regulation, initiated by the Carter
presidency and facilitated, or openly canvassed, by successive administrations ever
since.

Spitzer’s ingenuity lies in his unerring capacity to capture the political
zeitgeist concerning public unease and revulsion at the excesses associated with the
once deified icons of the business world. On the campaign stump he is fond of
quoting Jack Grubman’s famous phrase that “what were once conflicts are now
synergies”. As he continues his pursuit for higher office, it is a warning that he would
do well to remember.

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John Wiley & Sons, 2003); Roger Lowenstein, The Origins of the Crash, (New York:
The Penguin Press, 2004); John K. Galbraith, The Economics of Innocent Fraud,

The widening investigation into AIG is a crucial example of this dynamic. Spitzer’s call through the Martin Act for information relating to the use of contingent commissions has sprawled outwards to include not just the SEC and the Department of Justice but regulators in a range of countries, including the United Kingdom, Australia and the Republic of Ireland, which has become one of the leading global centres in the insurance industry. See Timothy L. O’Brien, “Investigation of Insurance puts Buffett in a Spotlight,” *New York Times*, 28 March 2005, p. C1.

5Interview, New York City, 10 December 2004.


8Full text online at http://oag.state.ny.us/press/2005/jan/marsh_agreement.pdf


10Interview, New York City, 10 December 2004.
11NYSAG, Statement By Attorney General Eliot Spitzer Regarding the AIG Investigation, 4 April 2005.


15The quotation comes from a seminal article, written by the sociologist Edward Ross in 1907, the first sustained critique of white-collar crime. See Edward Ross, “The Criminaloid,” The Atlantic Monthly, January 1907, pp. 44-50. David Browne, the Managing Director of the boutique investment firm Tweedy Browne, scathingly refers to Spitzer as a contemporary muckraker. In an interview conducted in Hamilton,
Ontario, on 20 January 2005, he decried Spitzer as “a political egomaniac.” Browne was instrumental in orchestrating the demise of the press magnate Conrad Black in what emerged as one of the most egregious corporate governance failures in the current crisis.


17 Interview, New York City, 10 December 2004.

18 Editorial, “Eliot Spitzer for Attorney General,” New York Times, 29 October 1998, p. A30. Condemning what it termed his ‘campaign trickery” the editorial argued that “in normal circumstances, Mr. Spitzer's evasions would have made it impossible to endorse him for the state's top legal position… Mr. Spitzer, for all his dishonesty on campaign funding, does offer the prospect of an attorney general who will not be hobbled by ideology.” Spitzer’s electoral strategy has once again come into clear focus with the revelation that the internet search company Google was paid to provide a link from AIG to his gubernatorial campaign. See Christopher Grimes, “Google link
puts Spitzer in the line of fire,” Financial Times, 7 April 2005 (Internet Explorer version).

19 Spitzer had not been elected when the multi-state tobacco litigation was designed. Prior to his investigations on Wall Street, his most effective litigation involved suing power plants in the Mid West for causing the pollutants that fall as acid rain on New York. See, “Spitzer Files Law Suits Against Out of State Power Plants”, 29 November 1999; http://www.oag.state.ny.us/press/1999/nov/nov29a_99.html. Two major utilities settled in November and December 2001. He had also secured a major settlement for environmental clean ups in New York State in December 1999. See, “State Secures $9 million in Toxic Clean Up,” 27 December 1999; http://www.oag.state.ny.us/press/1999/dec/dec27a_99.html.

20 O’Brien, Wall Street on Trial, p. 152; Gasparino, Blood on the Street, pp. 216-217. In an interview, the Director of Enforcement at the Securities and Exchange Commission, Steve Cutler, argued that “the timeline demonstrates conclusively that this issue was already being addressed by the regulatory authorities” (Interview Washington DC 23 May 2003). Spitzer’s success was in taking the issue public just as Congress was holding financial hearings into the complicity of financial institutions into the collapse of Enron. By holding Merrill Lynch to account for failures in the wider securities and investment banking industry, the authorities had little choice but to co-opt the New York SAG. In Cutler’s diplomatic phrasing, up to that point the regulators had been engaging in “the kind of parallel play you associate with toddlers.”
Interview, New York City, 10 December 2004.


O’Brien, Wall Street on Trial, p. 155.


O’Brien, Wall Street on Trial, p. 167.

Having the case heard does not necessarily guarantee victory. A class action was filed in the Southern District of New York against Merrill Lynch, using the evidence provided by Spitzer’s investigation. Judge Milton Pollack ruled he was “utterly unconvinced.” He castigated the ‘plaintiffs [who] would have this court conclude that the federal securities laws were meant to underwrite, subsidize and encourage their rash speculation in joining a free-wheeling casino that lured thousands obsessed with the fantasy of Olympian riches, but which delivered such riches to only a scant handful of lucky winners” (p. 7). For full details of the ruling see Re Merrill Lynch &
The ruling was upheld on appeal. See, Lentell et al vs. Merrill Lynch & Co Inc and Henry Blodget, US Federal Court of Appeals 2nd Circuit, 03 7948 (20 January 2005).

29“Citigroup to Set Aside $4.95 Billion for Litigation,” www.bloomberg.com 10 May 2004. A total of $2.58 billion related to a class action suit related to the bank’s complicity in the collapse of WorldCom. As with the Merrill Lynch case cited above, much of the evidence implicating the bank was sourced to Spitzer’s investigation. It was entered into evidence in the consolidated complaint issued by the New York State Comptroller, Alan Hevesi, on behalf of the common retirement fund. For full details see, “Consolidated Complaint,” Re World Com Inc Securities Litigation, SDNY 02 Civ. 3288 DLC (2 December 2003). The day after the former WorldCom chief executive, Bernie Ebbers, was convicted on nine charges of fraud, JP Morgan Chase settled its liabilities for $2 billion. The price for settlement went up seventeen per cent in the intervening period. With remarkable understatement, JP Morgan’s chief executive, William Harrison released a statement in which he argued that “given recent developments, we made a decision to settle rather than risk the uncertainty of a trial.” See, “JP Morgan Settles WorldCom Suit for $2bn,” Washington Post, 17 March 2005, p. E1

30For a discussion of the importance of symbolism in regulatory politics, see Murray Edelman, “Symbols and Political Quiescence,” The American Political Science Review 54 (September 1960): 695-704. For its application to the current
manifestation, see O’Brien, “Ethics, Probity and the Changing Governance of Wall Street.”

31 O’Brien, Wall Street on Trial, p. 144.

32 For an assessment of these dynamics in the earlier Savings and Loans debacle, see Julie Laumann and Paul Teske, “Principals, Agents and Regulatory Federalism in the Savings and Loan Crisis of the 1980s”, State Politics and Policy Quarterly 3 (Summer 2003) 139-57. For a trenchant critique arguing the case for increased state competition in order to improve regulatory capacity, see Roberta Romano, The Advantage of Competitive Federalism for Securities Regulation, (Washington:AEI Press, 2002).

33 Public Law No. 109-2.


dispensation, see Provost, “State Attorneys General” and Teske, Regulation in the States, pp. 218-235.


41 Interview, New York City, 10 December 2004.


43 Mark Seliger, ‘Spitzer’s Justice,” Vanity Fair, January 2005.

44 Brandeis remains controversial figure. For contrasting perspectives, see Phillpa Strum, Brandeis: Beyond Progressivism, (Kansas: University Press of Kansas, 1992)


47 Interview, New York City, 10 December 2004.

48 Interview, New York City, 10 December 2004.


51 Interview, New York City, 10 December 2004.
New York State Constitution, Article 5, section 1.4, and Article 19, section 1.

Eliot Spitzer, Statement to Senate Committee on Governmental Affairs Subcommittee on Financial Management, the Budget and International Security, Washington DC, 16 November 2004, p. 13; www.oag.state.ny.us/press/statements

Teske, Regulation in the States, p. 7.


Public Law No. 107-204.

Sarbanes-Oxley serves four interlinked purposes. It creates new structures to regulate the audit process and the profession; offers greater protection for whistleblowers; increases the responsibilities and criminal liabilities of corporate boards; and enhances the authority of the SEC to police the market. As such, Sarbanes-Oxley imposes new restrictions on the capacity of corporations seeking to raise finance on US capital markets. To secure access to the liquidity offered on the primary exchanges all corporations, regardless of domicile must follow the more restrictive provisions of the act. They must also follow stricter listing requirements mandated by the primary exchanges under the guidance of a more assertive SEC. For a discussion of the act and how it operates, see Justin O’Brien ed. Governing the Corporation, (Chichester: John Wiley and Sons, 2005).
In this he is following the lead by two of the most senior judges in the Delaware Chancery Court. See, William Chandler and Leo Strine, “The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State”, *University of Pennsylvania Law Review*, 152 (December 2003): 954-1005.
