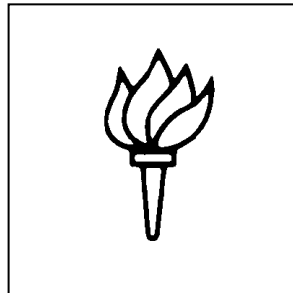


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The Prosecutor as Regulatory Agency

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The Prosecutor as Regulatory Agency
Rachel E. Barkow*

The simple account of America’s system of separated powers has legislators responsible for making laws, the executive branch (and prosecutors within it) charged with enforcing the laws, and judges with the power to adjudicate any disputes by declaring what the law commands. Two aspects of our modern government that have disrupted this paradigm – judicial and agency policymaking – have become scholarly obsessions.¹ But there is another, equally strong challenge to the traditional separation-of-powers framework that has received far less attention: prosecutors who regulate.

The constitutionally limited role of the prosecutor is to “take care that the laws be faithfully executed”² – that is, to enforce the policies laid down in laws enacted by the legislature. Whether this was ever true, it is certainly not the case today that prosecutors are merely enforcing pre-established rules. Armed with expansive criminal codes and broadly worded statutes, plus the ability to threaten harsh and mandatory sentences, prosecutors have so much leverage in negotiations with defendants that they have, for all practical purposes, taken on the role of adjudicator as well. The prosecutor alone decides a defendant’s liability and sentence.

This adjudicative authority gives prosecutors leverage to engage in lawmaking power as well. Because criminal laws themselves are broad, power is delegated to prosecutors to define what those laws mean, establish what conduct within the broad parameters of the law they wish to target, and dictate how that conduct should be punished. This power is akin to that of administrative agencies to define the

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¹ Barry Friedman, *The Birth of an Academic Obsession: The History of the Countermajoritarian Difficulty, Part Five*, 112 YALE L.J. 153 (2002); Rachel E. Barkow, *Administering Crime*, 52 UCLA L. Rev. 715, 755 n.135 (2005).

² U.S. Const. Art. II. § 3.

meaning of regulatory statutes.³ One could argue, however, that, despite its scope, this kind of regulatory power is inherent in executive power. The power to charge will necessarily include some policymaking given the necessary breadth in the way laws are written.

But prosecutorial regulatory power has gone further than the incidental power to regulate that comes with enforcement discretion. In the area of corporate crime in particular, prosecutors have gone beyond law interpretation and the pursuit of punishment for what they believe to be past violations of existing criminal laws. In this context, prosecutorial goals are sometimes more grand, with prosecutors seeking to reform the way companies do business going forward. As with prosecutions against individuals, prosecutors gain this power because of their ability to exact a high price if a defendant opts to exercise its trial rights. Indeed, with companies, it is not merely the threat of trial that is powerful. Many corporations in the financial sector face heavy losses with an indictment, let alone a conviction. As a result, companies are more than willing to accept prosecutors' regulatory demands to avoid a criminal charge. Prosecutors, for their part, do not want to face the hard choice of either letting companies off the hook or indicting them when it could mean substantial harm to shareholders and employees.

Prosecutors have therefore recently embraced a third option: regulation. They have increasingly reached agreements with companies that allow the companies to avoid indictments so long as they meet the prosecutors' regulatory terms. The agreements go by different names. In the federal system, they consist of non-prosecution agreements (NPAs) and deferred prosecution agreements (DPAs). In some states, they are known as settlement agreements. When the agreements require companies simply to obey the law or pay for prior bad acts, they are not particularly noteworthy from a separation of powers perspective because they are incidental to executive power.

³ Dan Kahan, *Is Chevron Relevant to Federal Criminal Law?*, 110 HARV. L. REV. 469, 479-81 (1996).

But in many of these agreements, prosecutors impose affirmative obligations on companies to change personnel, revamp their business practices, and adopt new models of corporate governance. These dictates are often sweeping and some prosecutors have imposed them on industries, not just isolated companies. These prosecutorial commands have been imposed without legislative guidance, much less relatively clear rules or intelligible principles. They resemble, in significant respects, the structural injunctions courts have imposed in areas like prison and school reform⁴ and the regulations promulgated by administrative agencies.

Judges and regulatory agencies have been closely scrutinized to determine whether they have the accountability, institutional competence, and procedural reliability to regulate. This Chapter considers prosecutor-imposed regulations using the same metrics. The most sweeping regulations have come from the New York Attorney General (NY AG), but federal prosecutors have also imposed significant regulatory requirements on companies as part of deferred and non-prosecution agreements. This Chapter will therefore consider the capacity of both state AGs and federal prosecutors to act as regulators.⁵

Part I begins by explaining the forces that give prosecutors the ability to go beyond law enforcement and step into a lawmaking role as well. Part II describes prosecutor regulation by chronicling some of the major regulations prosecutors have imposed on companies. Part III then evaluates the prosecutor's office as a regulatory agency by considering its democratic accountability, institutional competence, and procedural reliability.

⁴ Brandon L. Garrett, *Structural Reform Prosecution*, 93 Va. L. Rev. 853 (2007).

⁵ There are federalism and balkanization issues raised when any state actor, including a prosecutor, regulates a field that is also addressed by a federal body, but those issues are beyond the scope of this Chapter.

I. The Power To Regulate

Prosecutors today exercise a broad range of authority. Their power to enforce the law is uncontroversial. More worrisome from a separation-of-powers perspective are the adjudicative and lawmaking activities that are becoming increasingly common in prosecutors' offices around the country.

Prosecutors have taken on adjudicative powers due to several dynamics.⁶ First, many criminal laws are written in broad terms, and often more than one law covers a defendant's conduct.⁷ These laws typically authorize different sentences, so a prosecutor can select the sentence or sentencing range by choosing one law over another.⁸ This gives the prosecutor significant bargaining power because he or she can threaten to charge a defendant with a more serious crime if the defendant opts to take his or her case to trial. Second, many jurisdictions have turned to mandatory minimum sentences or sentencing guidelines, both of which limit judicial sentencing authority. The result is that a prosecutor's charging decision is more likely to dictate a particular sentence or narrow sentencing range. Third, many jurisdictions, like the federal system, give defendants substantial sentencing discounts for cooperating with the government and accepting responsibility. Prosecutors typically control downward departures for cooperation, and acceptance of responsibility reductions are usually disallowed when defendants exercise their trial rights or are discounted when defendants wait too close to the eve of trial before pleading guilty.

The final keys to this system of prosecutorial dominance are the reluctance of the judiciary to police it and legislative efforts to foster it. Prosecutors can threaten defendants with far more severe charges if they exercise their trial rights, and courts have refused to analyze these threats under the

⁶ Rachel E. Barkow, *Institutional Design and the Policing of Prosecutors*, 61 Stan. L. Rev. 869 (2009).

⁷ William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 Mich. L. Rev. 505, 512 (2001).

⁸ *Id.* at 552.

traditional unconstitutional conditions framework.⁹ For their part, legislators now pass laws with the goal of furthering this plea bargaining framework. Instead of limiting prosecutorial discretion through narrower, more precise laws, legislatures continue to pass broadly worded statutes that increasingly include punishments that are much higher than the facts of the typical case in violation of the statute would justify.

The end result is a criminal justice system in which roughly 95% of convictions are the result of pleas instead of trials, and prosecutors are the adjudicators. The exercise of the trial right is simply too costly for most defendants, leaving prosecutors to decide a defendant's liability and sentence.

Corporate criminal liability is no exception to this overall regime of prosecutorial leverage. If anything, it is a more extreme example. The standard for corporate liability is itself broad. Corporations are criminally liable if any employee in the scope of his or her employment commits a crime with the intent to benefit the company. This low threshold for liability makes it easier for prosecutors to obtain indictments and meet their burden at trial, which in turn makes it more likely that corporate defendants will plead guilty.

In addition to the broad legal standard, the reputational hit from a conviction or even just an indictment can be devastating or fatal, depending on the company's line of business. Some companies can survive an indictment and conviction. They pay their fine, and they move on. But for others, a conviction is equivalent to a death sentence because the company loses its eligibility to be licensed. Indeed, for some companies, even an indictment can be "a matter of life and death" because the damage to their reputations is irreparable.¹⁰ In the financial services and accounting industries in particular, a reputation for integrity is critical to the success of a corporation. The story of Arthur Andersen, which opted to go to trial instead of reaching an agreement with the government, is a perfect illustration of this

⁹ *Bordenkircher v. Hayes*, 434 U.S. 357 (1978).

¹⁰ *United States v. Stein*, 435 F.Supp.2d 330, 381-382 (S.D.N.Y. 2006).

phenomenon. When Andersen was indicted, clients abandoned the company in droves. The conviction of the company was the fatal blow, with the company collapsing when it was debarred by the SEC.

This kind of leverage has allowed prosecutors, in the words of one Assistant United States Attorney (AUSA), to “get[] the sort of significant reforms you might not even get following a trial and conviction.”¹¹

II. The Practice of Regulating

Both federal and state prosecutors have used their leverage to impose regulations on companies.

Regulation by Federal Prosecutors. As the introduction explains, DPAs and NPAs have been used in a range of areas, from securities to health care fraud, from money laundering and tax fraud to Foreign Corrupt Practices Act violations. Indeed, since the beginning of 2003, when the Department of Justice provided guiding principles for prosecuting business organizations in the so-called Thompson Memo, DPAs have gone hand-in-hand with the filing of federal criminal charges against any major corporation.¹² In addition, the federal Organizational Sentencing Guidelines expressly provide that companies may be required, as a condition of probation, to “eliminate or reduce the risk that the instant offense will cause future harm.”¹³ The guidelines also provide for sentence reductions for companies that adopt certain compliance and ethics regimes.¹⁴

As a result, federal prosecutors now operate within a legal culture that expressly acknowledges a role for prosecutors in corporate governance. When federal prosecutors follow the Guidelines standards for compliance and ethics regimes, they are operating under a scheme approved by Congress, so it is not fair to label those terms “prosecutorial” regulations. Similarly, when agreements simply insist upon

¹¹ Garrett, *supra* note __, at 861.

¹² Spivack & Raman, *supra* note __, at 167.

¹³ U.S.S.G. §8B1.2(a).

¹⁴ §8B2.1

personnel changes to rid the company of individuals engaged in wrongdoing or those who failed to prevent it, prosecutors are imposing a remedy directly tied to the past violation.

But many DPAs and NPAs go further and directly regulate the company's operations going forward. These are the conditions that are fairly characterized as regulations. For example, after engaging in a fraudulent scheme to inflate its earnings, Bristol-Myers Squibb (BMS) signed a DPA that required the company to submit specific financial disclosures that go beyond the requirements currently imposed by law, to establish a training and education program, and to adopt additional operational changes recommended by the monitor. Some agreements in the health care arena provide further illustrations of this kind of regulation. Stryker Orthopedics, a medical device manufacturer, entered into an NPA that restricted the company's ability to pay medical consultants. Zimmer Holdings, another device manufacturer, signed a DPA that similarly regulated its relationship with medical consultants, including setting caps on the number of consultants that could work on a product development team and setting hourly wage rates.

Other agreements have imposed restrictions on companies to prevent them from engaging in otherwise lawful business practices for fear that they will cross the line into illegality. For instance, the Canadian Imperial Bank agreement responded to the company's participation in the Enron fraud by prohibiting the bank from engaging in certain structured finance transactions. Agreements with KPMG and German Bank HVB bar them from marketing or selling pre-packaged tax products in response to their marketing of fraudulent tax shelters.

In each of these examples, the agreements go beyond bans on illegal conduct or the removal of negligent or criminal personnel and dictate affirmative changes in business practices and governance. As the Chair of the Attorney General's White Collar Crime Subcommittee informed Congress, the express goal of these agreements is "to root out illegal and unethical conduct, prevent recidivism, and

ensure that they are committed to business practices that meet *or exceed applicable legal and regulatory mandates.*”¹⁵ In the words of former United States Attorney for the Southern District of New York, Mary Jo White, these agreements effectively turn federal prosecutors into “super-regulators.”¹⁶

Regulation by State Prosecutors. While federal prosecutors have engaged in the regulation of some companies through DPAs and NPAs, some state attorneys general have been even more ambitious and have sought to regulate whole industries.¹⁷ State attorneys general have long played a major role in changing company business practices through their enforcement of state antitrust, environmental, and consumer laws and through novel multi-state litigation efforts. In recent years, some AGs have gone beyond this model and have used general criminal law enforcement power to achieve regulatory goals.

In particular, in the last decade, the NY AG’s Office has been more active than any other prosecutor’s office in regulating corporate behavior. One reason New York AGs are able to be particularly aggressive is that they have a powerful state law at their disposal, the Martin Act.¹⁸ The Martin Act gives the state AG broad powers to address financial fraud. With just about every public company traded on the New York Stock Exchange or NASDAQ, almost all securities fall within the Martin Act’s jurisdiction. The Act allows the AG to bring civil or criminal charges for securities fraud, and even in criminal cases it does not require showing either that the defendant intended to defraud or that anyone was actually defrauded.¹⁹ The AG has the discretion to conduct a confidential investigation or a public one. Once the AG starts an investigation under the Act, the Act requires the company being

¹⁵ Statement of David E. Nahmias, United States Attorney, Northern District of Georgia, and Chairman, White Collar Crime Subcommittee, Attorney General’s Advisory Committee of United States Attorneys, United States Dept of Justice, Before the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, United States House of Representatives, on “Deferred Prosecution: Should Corporate Settlement Agreements Be Without Guidelines” March 11, 2008 (emphasis added).

¹⁶ Mary Jo White, *Corporate Criminal Liability: What Has Gone Wrong?*, PLI Order No. 6063 (Nov. 2005).

¹⁷ In rare cases, DAs have imposed regulations on companies. See, e.g., Nassau County settlement with Walmart.

¹⁸ N.Y. Gen. Bus. Law Art. 23-A, §352 et seq (McKinney 1996).

¹⁹ Frank C. Razzano, *The Martin Act: An Overview*, 1 J. Bus & Tech. Law 125, 126 (2006).

investigated to provide the AG with “all the facts and circumstances concerning the subject matter” of the investigation and “such other data and information” as the AG deems relevant. The Act gives the AG broad subpoena power, and failure to comply with the subpoena without reasonable cause is a misdemeanor and prima facie evidence of fraudulent conduct.²⁰ This subpoena power includes the authority to bring witnesses to the AG’s office for so-called “Martin Act hearings.” Courts have held that witnesses have no right to counsel at Martin Act hearings nor are they entitled to a transcript of the proceedings.²¹ As one commentator has observed, “the act’s powers exceed those given any regulator in any other state.”²²

Attorney General Eliot Spitzer was the first AG to make expansive use of the Martin Act to impose regulations on companies,²³ using it to reform abusive practices in the securities, mutual fund, and insurance industries. Spitzer used his investigative powers under the Martin Act to uncover a conflict of interest between research analysts and investment bankers at the nation’s top investment firms. Through the Martin Act’s subpoena power, Spitzer obtained emails sent by Merrill Lynch stock analysts, which led him to the discovery that stock recommendations by Merrill’s analysts were influenced by whether the company issuing the stock had promised to give its banking business to Merrill. When Spitzer made his investigation of the company and his findings public, the market value of Merrill’s stock decreased by \$5 billion within a week. Spitzer quickly brought a similar case against Salomon Smith Barney and eventually targeted the rest of the top ten investment banking firms.

The SEC later joined Spitzer’s efforts and together they reached settlement agreements with the ten largest investment firms. To avoid prosecution, those firms agreed to “dramatically reform their

²⁰ Louis Loss, Joel Seligman & Troy Paredes, 1 Securities Regulation 167-168 (4th ed. 2006).

²¹ Carey S. Dunne, *Role of the States Attorneys General in Policing the Securities Markets*, 1344 PLI/Corp 1079, 1087-1092 (2002).

²² Nicholas Thompson, *The Sword of Spitzer*, Legal Affairs 50 (June 2004).

²³ Previous New York Attorney Generals used the law for small-time frauds and scams. *Id.*

future practices.”²⁴ Specifically, they agreed, among other things, to physically separate their research analysts from their investment bankers, to stop their practice of having analysts accompany investment bankers on pitches and road shows, to create firewalls restricting interaction between the two departments, and to cease basing analyst compensation in any way on investment banking revenue. The agreement also included a five-year commitment by the investment companies to “contract with no fewer than three independent research firms that will make available independent research to the firm’s customers.” The firms further promised to pay for investor education and to restrict their practice of “spinning,” whereby the firms would allocate securities in particularly hot initial public offerings to certain executive officers and directors who could influence investment banking decisions.²⁵ The firms additionally agreed to make publicly available their ratings and price target forecasts.²⁶ As Eliot Spitzer put it, the agreement’s goal was to “permanently change the way Wall Street operates.”²⁷

Spitzer followed a similar path with respect to his regulation of mutual funds. In the course of investigating Morgan Stanley because brokers there were promoting in-house funds without disclosing that they received higher commissions for selling those funds, Spitzer discovered that mutual fund managers were allowing some clients to trade after hours and to engage in other market-timing transactions.²⁸ The clients who were permitted to perform these transactions profited at the expense of other shareholders. Mutual fund managers engaged in this preferential treatment because they received profit-sharing and other fees.²⁹ Spitzer eventually expanded the scope of his inquiry to target a number

²⁴ Joint Press Release, Ten of Nation’s Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking, Mon. Apr. 28, 2003, available at <http://www.sec.gov/news/press/2003-54.htm>.

²⁵ *Id.*

²⁶ SEC, NY Attorney General, NASD, NASAA, NYSE, and State Regulators Announce Historic Agreement to Reform Investment Practices, available at http://www.oag.state.ny.us/media_center/2002/dec/dec20b_02.html.

²⁷ *Id.*

²⁸ “Market timing is ‘the practice of short-term buying and selling of mutual fund shares in order to exploit inefficiencies in mutual fund pricing.’” Harold S. Bloomenthal, *Securities Law Handbook* § 20:18.10 (Dec. 2008).

²⁹ *Id.*

of the largest investment companies. Faced with criminal prosecution, they reached agreements with the AG's office to modify their business practices.³⁰ For example, in the AG's agreement with Alliance Capital Management, the company agreed to new disclosure requirements about its expenses and fees and to hire a full-time senior officer to ensure that mutual fund fees would be negotiated at arm's length. The SEC eventually joined the effort, and together the AG's office and the SEC reached settlements with the targeted firms, and the SEC later imposed industry-wide rules to address the issue.³¹ Spitzer went further than the SEC was willing to go by additionally insisting that the mutual funds reduce their fund fees by 20 percent and maintain that reduced rate for a five-year period.³²

The insurance industry was another Spitzer target. His office investigated Marsh & McLennan, AIG and other large insurance brokers for accepting kickbacks from insurers and setting up a bid-rigging scheme.³³ After Marsh was indicted, its stock fell by 24%.³⁴ Seeking to avoid a further decline, the company agreed to the AG's terms for settling the case, which involved sweeping reforms in its business practices. In particular, the company agreed to discontinue receiving contingent compensation from insurance carriers, to provide clients with more comprehensive disclosure about the compensation it receives from insurers, to adopt a company-wide written standard for the placement of insurance, and

³⁰ Other states also pursued mutual fund fraud. *See, e.g.*, Press Release, California Attorney General Bill Lockyer, Attorney General Lockyer Launches Investigation of Fraudulent Sales Practices by Mutual Funds (Jan. 2, 2004), available at www.ag.ca.gov/newsalerts/2004/04-001.htm; News Release, Attorney General Lockyer Announces \$9 Million Settlement with PA Distributors in PIMCO Fund Case (Sept. 15, 2004), available at <http://ag.ca.gov/newsalerts/release.php?id=796>.

³¹ Compliance Programs of Investment Companies and Investment Advisers, 68 Fed. Reg. 74714 (Dec. 24, 2003) (codified at 17 C.F.R. §§ 270.38-1, 275.206(4)-7, 275.204-2 & 279.1).

³² See Alliance Agreement Includes New Form of Relief for Shareholders, available at http://www.oag.state.ny.us/media_center/2003/dec/dec18c_03.html.

³³ Spitzer Sues Marsh & McLennan, Associated Press, Oct. 14, 2004 (listing Marsh, AIG, Ace Insurance Company, The Hartford, and Munich American Risk Partners as targets).

³⁴ Kulbir Walha & Edward E. Filusch, *Eliot Spitzer: A Crusader Against Corporate Malfeasance or a Politically Ambitious Spotlight Hound? A Case Study of Eliot Spitzer and Marsh & McLennan*, 18 Geo. J. Legal Ethics 1111, 1127 (2005).

to establish a compliance committee.³⁵ AIG and other insurance brokerage companies agreed to similar changes to their business practices.

Andrew Cuomo succeeded Spitzer as New York's AG in 2007 and picked up where Spitzer left off, negotiating similarly sweeping settlements with the health care and student loan industries. Early in his tenure, Cuomo's office began an investigation into the health care industry's in-network doctor ranking programs, an increasingly widespread practice where insurers rank doctors according to certain metrics of quality and cost efficiency. Cuomo concluded that insurers have a potential conflict of interest when recommending doctors to consumers because the insurer pays for the care given by the doctor it recommends, giving it an incentive to recommend the cheapest, not necessarily the best, doctors.³⁶ Cuomo looked to the state's business laws against deceptive practices instead of the Martin Act to pursue the companies, and he reached his first settlement agreement with CIGNA in October of 2007. That agreement established a new code of conduct for ranking doctors. The agreement requires health care companies to disclose how doctors are ranked, to employ separate categories of "quality of performance" and "cost efficiency," to identify the extent to which any ranking is based on cost, to use more accurate measures to compare physicians including the use of nationally-recognized evidence-based and/or consensus-based clinical recommendations or guidelines, to allow consumers to register complaints about the system, and to provide a process by which physicians can appeal the rankings. In addition, the agreement specifies that CIGNA will be monitored by a ratings examiner that will oversee

³⁵ Marsh Reaches \$850 Million Deal with N.Y. AG Spitzer and Insurance Department, Insurance Journal, available at <http://www.insurancejournal.com/news/national/2005/01/31/50470.htm?print=1>.

³⁶ See N.Y. ATT'Y GEN., UNITEDHEALTHCARE AGREEMENT CONCERNING PHYSICIAN PERFORMANCE MEASUREMENT, REPORTING AND TIERING PROGRAMS 1 (Nov. 15, 2007), available at http://www.oag.state.ny.us/media_center/2007/nov/United%20Final%20Executed.pdf.

compliance with the code of conduct. Cuomo has used the CIGNA agreement as a model for subsequent agreements with the industry's largest insurers, and it has become the industry standard.³⁷

Cuomo has also reformed the health insurance industry's methods for reimbursing patients for out-of-network health care. Prior to reaching settlements with the AG's office, many of the nation's largest health insurance companies set the rates at which they would reimburse out-of-network care based on a schedule compiled by a data company called Ingenix. Cuomo's office found several problems with the practice. First, Ingenix is a wholly-owned subsidiary of UnitedHealth, one of the health insurers. Second, Ingenix set the rates on the basis of data submitted by the insurers, all of whom had the incentive to manipulate the data to lower the reimbursement rates calculated in the schedule. Finally, the companies did not inform consumers of the reimbursement rates, putting customers in the situation of choosing doctors without knowing what costs would be covered by their insurer.³⁸

As with the doctor-ranking system, Cuomo used the state's laws against deceptive business practices to reach settlements with some of the industry's largest companies imposing new regulations.³⁹ The centerpiece of all the agreements is the company's commitment to select a qualified school of public health to establish a new, independent database that will create reimbursement rates for at least five years.⁴⁰ The information in the database will be available on

³⁷ See CONSUMER-PURCHASER DISCLOSURE PROJECT, PATIENT CHARTER FOR PHYSICIAN PERFORMANCE MEASUREMENT, REPORTING AND TIERING PROGRAMS: ENSURING TRANSPARENCY, FAIRNESS AND INDEPENDENT REVIEW (Apr. 1, 2008), available at <http://healthcaredisclosure.org/docs/files/PatientCharter.pdf>.

³⁸ See generally N.Y. ATT'Y GEN., HEALTHCARE INDUSTRY TASKFORCE, HEALTH CARE REPORT: THE CONSUMER REIMBURSEMENT SYSTEM IS CODE BLUE (Jan. 13, 2009), available at http://www.oag.state.ny.us/bureaus/health_care/HIT2/pdfs/FINALHITIngenixReportJan.13.%202009.pdf.

³⁹ Cuomo reached agreements with AETNA, CIGNA, HealthNow, Independent Health, MVP Health Care, UnitedHealth, and WellPoint.

⁴⁰ See e.g., N.Y. ATT'Y GEN., AETNA ASSURANCE OF DISCONTINUANCE UNDER EXECUTIVE LAW § 63(15), Investigation No. 09-005, at 9-11 (Jan. 2009), available at http://www.oag.state.ny.us/bureaus/health_care/HIT2/pdfs/Aetna%20AOD%20Final.pdf.

a website available to the public, and the companies agreed to provide data, assistance, and money to help create the database.

Cuomo has also reformed the student loan industry by using the threat of prosecution. In 2007, his office uncovered various deceptive and illegal practices in the industry. For instance, his office found evidence that lenders were paying kickbacks to schools and giving school officials other benefits in exchange for being placed on the schools' preferred lender lists and otherwise getting preferential treatment. In response to these abuses, Cuomo drafted a College Loan Code of Conduct that specified new practices to govern lenders and schools.⁴¹ The Code prohibited lenders from giving anything of value to schools in exchange for being placed on a preferred lender list or otherwise gaining an advantage. The Code also required a school using a preferred lender list to disclose the criteria used to establish such a list and to make clear to students their right to select from any lender, including those not on the list. The Code further requires lenders to disclose information to allow consumers to easily compare the lender's terms with others, including federal loans. In the course of the investigation, Cuomo wrote letters to more than 400 colleges and universities demanding disclosure of any conflicts of interest. Many schools and lenders adopted the code by reaching settlement agreements with Cuomo's office.⁴² Ultimately, the Code made its way into federal and state legislation.⁴³

Cuomo is now tackling the subprime mortgage crisis. He reached a settlement agreement with Freddie Mac and Fannie that requires lenders who work with the agencies to reform their appraisal

⁴¹ N.Y. ATT'Y GEN., NEW YORK UNIVERSITY AGREEMENT ON CODE OF CONDUCT 1-4 (Apr. 2, 2007), *available at* http://www.oag.state.ny.us/bureaus/student_loan/PDFs/NYU%20AOD.pdf.

⁴² Press Release, N.Y. Att'y Gen., Attorney General Cuomo Announces Groundbreaking Settlements with 8 Companies that Market Student Loans Directly to Students and Their Families (Sept. 9, 2008), *available at* http://www.oag.state.ny.us/media_center/2008/sep/sep9a_08.html.

⁴³ Higher Education Opportunity Act of 2008, Pub. L. No. 110-315, 122 Stat. 3078 (codified in scattered sections of 20 U.S.C.); Student Lending Accountability, Transparency, and Enforcement Act (SLATE), N.Y. EDUCATION LAW §§ 620-632 (McKinney 2007).

practices by adopting what Cuomo calls a “New Home Valuation Protection Code.” In addition, the agreement also creates an independent agency to implement and monitor the new standards.⁴⁴

The last two New York AGs have taken the prosecutor-as-regulatory-agency model to new heights. Spitzer explicitly noted he was a “prosecutor-slash-regulator,” and the agreements that have emerged from his office and his successor more than back up his claim.

III. Assessing the Prosecutor as Policymaker

The model of the “prosecutor-slash-regulator” is in tension with a government based on separation of powers because that prosecutor is stepping into the role of policymaker by using his or her power to indict as leverage. Under a formalist account, to describe this lawmaking activity is to condemn it. Prosecutors are supposed to execute the law, not make it.

But courts and commentators increasingly dismiss a formalist approach to the separation of powers. Ours is now a government of blended powers across a range of areas, from administrative agencies to special prosecutors. The weak nondelegation doctrine that applies to administrative agencies rejects the notion that all policy judgments must rest with the legislative branch. How does regulation by prosecutors fit within this flexible modern order? Are the potential dangers sufficiently limited by checks and balances so that regulation by prosecutors is a social good?

These are difficult questions that will ultimately require more detailed empirical studies of how prosecutors are using this power. But one way to get a handle on these questions is to consider how regulation by prosecutors measures up when one applies the same institutional metrics that have guided analyses of judicial and agency policymaking. The key benchmarks in those contexts are accountability, institutional competence, and procedural reliability.

⁴⁴ New York Attorney General Cuomo Announces Agreement with Fannie Mae, Freddie Mac, and OFHEO, available at http://www.oag.state.ny.us/media_center/2008/mar/mar3a_08.html

A. *Accountability.* When critics attack judges for their remedial decrees or their recognition of certain rights, they inevitably make the argument that judges should not make policy because they are not democratically unaccountable. Debates about the administrative state similarly focus on accountability, with those skeptical of agencies focusing on the fact that they are run by unelected bureaucrats and those defending agencies emphasizing that they must answer to political overseers.

Where do prosecutors sit on the accountability continuum? The answer differs depending on whether the prosecutor is a state or federal actor.

State Prosecutors. The vast majority of state attorneys general (including New York's) are directly elected by the people. In the handful of states where they are not, they are appointed by someone who is.⁴⁵ Moreover, while the public may not pay attention to much of what state attorneys general do, they are more likely to pay attention when the state AG brings an action that results in sweeping corporate changes because those cases are likely to receive significant media attention. Eliot Spitzer and Andrew Cuomo earned sky-high favorability ratings as the NY AG precisely because of their activism in pursuing corporate regulations.⁴⁶ On the surface, then, there appears to be no accountability concern with state-level prosecutors.

Nevertheless, there are some reasons to doubt that prosecutors are being held accountable for their regulatory decisions even when they face direct election by the people. First, it is unclear that the public notices when prosecutors opt not to seek sweeping changes from companies. Unless the corporate fraud has already been investigated and well-publicized, an attorney general's failure to pursue

⁴⁵ In five states – Alaska, Hawaii, New Hampshire, New Jersey, and Wyoming – they are appointed by the governor. In Maine, the AG is selected by a secret ballot of the legislature. In Tennessee, the state's supreme court (which is itself elected) selects the attorney general. *State Attorneys General: Powers and Responsibilities* 15 (Lynne M. Ross, ed., 1990).

⁴⁶ In 2003, Spitzer had the highest job approval rating of any New York state official. Quinnipiac University, *Pataki Approval Inches Up, But Spitzer's is Better*, available at <http://www.quinnipiac.edu/x8347.xml> (Oct. 2, 2003). Cuomo's approval rating as of February 2009 was 71%. <http://www.maristpoll.marist.edu/nyspolls/NY090303.htm>.

a company is unlikely to garner much, if any, attention.⁴⁷ State AGs benefit from just about any media coverage that shows they are fighting crime or pursuing consumer interests. Because that be can satisfied with civil suits that obtain damages or criminal suits against individuals, it is not necessary for them to seek sweeping regulatory changes by threatening criminal prosecution. Just about every other AG, for example, has decided not to regulate corporations as aggressively as the NY AG, yet AGs everywhere, not just in NY, typically win reelection.⁴⁸ These AGs are not being penalized for failing to pursue regulation, which means that accountability is more of a one-way ratchet where only affirmative pursuits against companies get noticed and a failure to go after corporate wrongdoers is likely to escape public attention.

Second, even when the AG does act affirmatively to obtain new regulations against a company, there is little reason to believe that the public pays any attention to the details. The level of public knowledge about the terms of corporate regulations is not very deep. Andrew Cuomo has received as much attention – indeed, a great deal more – for his subpoena requests of AIG as he has for his entire re-regulation of the insurance industry.

To put the matter another way, the worry with elected prosecutor accountability is that voters might easily be misled to believe any action is good action. This can lead to two dangers. Most likely, elected prosecutors will tend to under-regulate because they have competing concerns that favor industry. As the former AG in Massachusetts has observed, “[y]ou rarely run for attorney general successfully by prosecuting the biggest corporations in your state, represented by the best law firms, with the best PR firms spinning it.”⁴⁹ There is a political risk in alienating such a powerful, wealthy group, and that means that some prosecutors will resist pursuing companies and others will reach

⁴⁷ Barkow, *supra* note __, at 1353.

⁴⁸ Stephen Ansolabehere and James M. Snyder, Jr., *The Incumbency Advantage in U.S. Elections: An Analysis of State and Federal Offices, 1942-2000*, 1 ELECTION L.J. 315, 326 (2002).

⁴⁹ Thompson, *supra* note __ (quoting Scott Harshbarger, former Attorney General of Massachusetts).

settlement agreements that are largely favorable to industry given the conduct at issue because most prosecutors do not want to anger such a wealthy and powerful constituency. To be sure, voters may share this interest because if a statewide prosecutor is too aggressive, companies may opt to cease doing business in the state. But there is likely to be some distance between the AG's interests and those of the voters. Thus, in most states, prosecutors will not take on the role of regulatory agency.

To the extent that the New York AG office has departed from this trend, it is because of unique legal and economic factors in the state. As noted, the Martin Act is part of the story. The law is unusually broad, so it gives an AG who wants to use it aggressively a big stick to go after companies. But it is New York's economic and political environment that has given the last two state AGs the incentives to take that approach.

Consider first the economics of the state. Eric Zitzewitz's analysis of the mutual fund cases shows that, assuming a major fraud scandal does not repeat itself frequently, companies earn enough profits operating in New York to override the costs imposed by the AG's settlement demands. But, as he notes, "the calculation is close enough that the conclusion may be different for a state that is significantly smaller or less wealthy than New York."⁵⁰ In other words, the New York AG can be aggressive because companies still get a net benefit operating in the state; other state AGs may worry that businesses will opt to leave their state if they make the regulatory environment too unfriendly.

New York is also unique in terms of the possible donor bases for an AG who seeks reelection or a higher office. New York AGs can raise campaign funds from a huge base of wealthy individual donors and companies across a broad range of industries. If the AG targets a few companies or even industries to regulate, there are still many others to whom he can turn for donations, not to mention thousands upon thousands of individuals. In many other states, just a handful of industries dominate the

⁵⁰ Zitzewitz at 32.

state's economic landscape, and those industries and the people who work in them are likely to make up a significant share of possible campaign support.

The danger in a state like New York, then, is not so much under-regulation, but ill-conceived regulation that targets particular companies or industries that are politically unpopular at the moment. The NY AG may seek regulations that go too far or do not directly address the criminal behavior at issue in an effort to give the AG short-term political goodwill as opposed to long-term benefits for the state or a sensible regime for an entire industry.

There is not much the targets of the AG's regulatory efforts can do to overcome this. While some companies can turn to the adversary system as a check on prosecutors, others (particularly public companies in the financial services industry) cannot because the reputational hit is simply too great. The staggering losses many of these companies incurred when the AG's investigations became public gives an indicator of prosecutorial leverage. Companies do not want to risk additional reputational damage and the resulting financial losses by going to trial and having more damaging facts come out. And because the standard for liability is so low, particularly with a law like the Martin Act, trial is likely to be unsuccessful in any event.

The problem for these companies is that they have employees who have engaged in conduct that is criminal or close enough to the line of legality that the company is unlikely to get public sympathy when it comes to the penalty phase. The public has little incentive to scrutinize closely the regulatory demands made on the companies to ensure that they are rational and proportional to the offense. As with so much of criminal law today, there is unlikely to be much, if any, attention paid to the reasonableness of the sentence because the public does not pay attention to the individual facts of cases to determine if the punishment is proportional. Instead, judgments are formed based on aggregate information or paradigm cases. In the case of corporate misconduct, that means a public highly unlikely

to consider whether a corporation is being regulated too much. Given this negative public sentiment, other elected officials are unlikely to step in to the company's defense if a regulation goes too far.

Federal Prosecutors. Federal prosecutors are not elected. Each United States Attorney is appointed by the President and confirmed by the Senate, and they are removable by the President. New administrations typically replace the previous administration's U.S. Attorneys as a matter of course so that their policies reflect those of the incoming administration.

But despite being subject to removal by the President, federal prosecutors retain a degree of independence. Although U.S. Attorneys are subject to Department of Justice oversight in various respects,⁵¹ the U.S. Attorney has a great deal of latitude in which cases to bring and how to handle them.

This degree of de facto independence may help explain why different U.S. Attorney's Offices take different approaches to DPAs and NPAs. There is no evidence that DOJ is issuing centralized commands – other than their broadly worded corporate charging memos – for U.S. Attorneys to follow. As a result, U.S. Attorneys are charting their own courses. Some districts seek DPAs and NPAs relatively frequently, whereas others have yet to enter into such an agreement at all. Even those districts that use these agreements diverge. The district of New Jersey has often imposed a requirement of an independent monitor, whereas the Southern District of New York did not make that a condition of any of its 2007 agreements.⁵²

Moreover, to the extent that federal prosecutors are subject to centralized oversight, the law enforcement official who is ultimate accountability to the people is the President. And it is unlikely that corporate charging and regulatory decisions factor in to any single voter's choice of President in light of more salient and important national issues. The link between federal prosecutors and the voting public is therefore tenuous at best.

⁵¹ There is centralized review by Main Justice, for example, in RICO cases, for wiretaps, and in capital cases.

⁵² Spivack and Raman, *supra* note ___, at 173.

Nor does the career path of the average U.S. Attorney make them any more attentive to public opinion. Most U.S. Attorneys have no interest in seeking an elected office. After their government service, they typically want to obtain a lucrative job in the private sector or get appointed to the federal bench or to an even higher position in the executive branch.⁵³ For those that want a political appointment, they will aim to please their political benefactors, typically powerful Senators or the President.

The biggest accountability danger in the federal context, then, is the same one that exists for most state AGs: the risk of under-regulation relative to public preference. Neither the President nor a Senator is likely to want prosecutors to regulate corporations too aggressively because they are powerful lobbyists and campaign contributors, and politicians might also be concerned about job losses and a decline in shareholder value.

It is more the exception than the rule when prosecutors opt for regulation. And although U.S. Attorneys operate with a great deal of independence, a sufficiently powerful corporate defendant can likely appeal the U.S. Attorney's decisions to someone at Main Justice if a U.S. Attorney's regulatory demands go too far. This, too, is likely to keep a federal prosecutor's regulatory demands in check.

Prosecutors v. Agencies. So far, the discussion has considered prosecutorial accountability to the public. But the real question of accountability is a relative one. Under our traditional separation of powers governing structure, the responsibility for regulating rests with the legislature. Legislative elections are likely to get more public attention than elections for state attorneys general, and legislators are certainly more accountable than appointed prosecutors.

But in modern American government, the reality is that legislators are not the basis for comparison. In most areas, legislators do not regulate but instead pass broadly worded statutes that

⁵³ See Richard T. Boylan, *What Do Prosecutors Maximize? Evidence from the Careers of U.S. Attorneys*, 7 AM. L. & ECON. REV. 379, 383 (2005).

delegate regulatory authority with administrative agencies. The critical accountability question, then, is not how prosecutors stack up against legislators in responding to the public, but how do they compare with agency regulators.

In general, when it comes to accountability, elected prosecutors have an edge over their agency counterparts. Agency heads are not typically elected, but appointed. In the few instances where they are elected – as they are in the case of some state agencies – voter turnout is abysmally low and the public knows almost nothing about the people who are running. And although agency heads are accountable in other ways – through congressional hearings or budget decisions, by Presidential appointment and (for some agencies) removal decisions, through oversight by the Office of Management and Budget (OMB)– these forms of oversight aim to place agencies under greater control of elected officials so that, in turn, agencies are more directly responsive to voters. But there is no evidence that these indirect measures are superior substitutes for direct voting by the people, particularly when the political officials who oversee agencies are going to be elected based on their performance across a range of issues (international relations, the economy, cultural issues, etc.).

Elected prosecutors, in contrast, are judged by the public on the cases they pursue, including those against corporations. And while it is true that voters are unlikely to hold elected prosecutors accountable for failing to regulate or for under-regulating, accountability for inaction or under-regulation is a problem for regulatory agencies as well.⁵⁴ Overall, then, the accountability of elected state AGs is therefore likely to be stronger than or at least as strong as it is for administrative agencies.

The comparison between appointed federal prosecutors and agency heads reveals many similarities as far as accountability is concerned. Consider first how federal prosecutors compare with the heads of executive agencies. Both face similar presidential oversight. They are appointed and

⁵⁴ Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 Colum. L. Rev. 1260 (2006).

removable by the President. Although executive agencies submit proposed regulations to OMB, they do not need to get OMB approval for policies announced in adjudications. Thus, prosecutors and executive regulatory agencies alike evade OMB review when they regulate through their adjudicative powers. Congressional oversight is also comparable. Although congressional hearings of executive regulatory agencies are more common than hearings involving prosecutorial policies, Congress has noticed the trend of regulation by federal prosecutors and stepped in when it viewed it as going too far. For example, Congress held hearings on the use of monitors in DPAs and NPAs, and DOJ responded with a set of guidelines. Similarly, when prosecutors were demanding that companies cease paying attorney fees for individuals under investigation and asking for attorney-client waivers as proof of cooperation, Congress proposed legislation that prompted DOJ to make changes to its policies. Federal prosecutors are therefore roughly on par with executive agencies when it comes to accountability to the President and Congress and, through them, the voting public.

And federal prosecutors are arguably more accountable than the heads of independent agencies. Although appointed federal prosecutors have some independence as a practical matter, the heads of independent agencies have insulation as a legal matter. They are removable only for cause, stripping the President of one of his strongest mechanisms for exercising control over regulatory policy.

Thus, to the extent we accept the democratic accountability of agencies, we should be comfortable with the accountability of prosecutors.

B. *Institutional Competence/Expertise.* Many of the “regulations” imposed in prosecution agreements go the heart of how these companies should operate. Should investment firms have to separate analysts from underwriters? How should late trading be reformed? What should be in the code of conduct for health insurance physician referrals? These questions go well beyond the question of

whether a company committed a crime or even what punishment is appropriate. A key issue is whether prosecutors have the institutional competence to decide these substantive issues.

An initial question is whether prosecutors have the necessary resources to regulate. It is not surprising that most NPAs, DPAs, and settlement agreements come from a handful of offices. They are among the largest offices, with a bevy of prosecutors who have experience with sophisticated white collar crime. But many federal offices and most state AG offices are smaller and lack the resources to properly investigate these cases and devise settlements that make sense. To the extent offices with fewer resources are taking on these cases, there is reason to be concerned that they may not have the time and staff necessary to think through an appropriate remedy.

Even in well-resourced offices, one can worry about expertise. Much turns on whether prosecutors are deciding these issues on their own or in consultation with relevant subject-matter experts, typically those at an expert agency like the Securities and Exchange Commission. Although it is hard to get concrete data on all federal and state prosecutions involving corporate regulation, it seems that consultation with expert agencies is fairly commonplace even if it is not formally institutionalized.

At the federal level, the ties between experts and prosecutors are stronger than in the states because there are longstanding institutional relationships between federal prosecutors and expert agencies. For starters, many, if not most, instances of corporate wrongdoing are likely to come to the attention of federal prosecutors as a result of a regulatory investigation. Federal regulatory agencies cannot bring criminal prosecutions on their own; they must persuade the Department of Justice to bring criminal charges.⁵⁵ As a result, in most cases, regulatory agencies will already be in contact with federal prosecutors about how the case should proceed, and their views are likely to be considered. This may explain why regulatory agencies are explicitly mentioned in two-thirds of deferred prosecution

⁵⁵ Michael Herz, *Structures of Environmental Criminal Enforcement*, 7 Fordham Env'tl. L.J. 679, 706 (1996).

agreements – a figure which likely understates agency involvement because interactions undoubtedly occur that do not get mentioned in the agreements themselves.⁵⁶

In addition, the President's Corporate Fraud Task Force creates an institutional framework specifically designed to foster cooperation between experts and prosecutors in corporate criminal matters. Created in 2002, the Task Force is an inter-agency group that includes among its membership the Chairman of the SEC, the Chairman of the Commodities Futures Trading Commission, the Security of the Treasury, the Secretary of Labor, and the Chairman of the Federal Reserve. This working group allows the expert agencies and federal prosecutors to cooperate in investigating and prosecuting corporate crime.⁵⁷ The Task Force also addresses institutional questions, such as how to allocate Department of Justice resources in fighting corporate crime and how to promote cooperation among government agencies.

These institutional ties may help explain why federal DPAs and NPAs have been more measured in the regulatory obligations they have imposed on companies than those imposed by the NY AG. Federal prosecutors may be more reluctant to usurp the power of expert agencies and insist on broader regulatory reforms when they are in a long-term institutional dialogue and need to work together with these agencies on these types of cases in the future.

There is no similar institutional relationship between state prosecutors and the relevant governing agencies, so the influence of these agencies is likely to be less significant. To be sure, sometimes, maybe often, state prosecutors will make the effort to reach out to the relevant experts for guidance. In New York, for example, Eliot Spitzer began his investigations into investment firms without much

⁵⁶ Daniel Richman, *Institutional Competence and Organizational Prosecutions*, 93 Va. L. Rev. In Brief 115, 116 (2007).

⁵⁷ See Exec. Order No. 13,271, 67 Fed. Reg. 46,091, 46,091-92 (July 9, 2002), available at <http://www.usdoj.gov/dag/cftf/execorder.htm>.

consultation with the SEC.⁵⁸ As time went by, however, he began to consult the SEC about settlements.⁵⁹ Andrew Cuomo consulted with the American Medical Association and the Medical Society of the State of New York as well as numerous consumer groups before developing the code of conduct that governs how health care companies rank doctors.⁶⁰

Nevertheless, the NY AG has hardly deferred to the SEC's judgment in all cases. The starkest example is the divergent response of each regulator to the mutual fund abuses of market timing and late trading. As noted, Spitzer's office insisted that mutual funds lower their fees by 20% for a five-year period as part of their settlement agreement with the AG's office. The SEC disagreed and even issued a press release explicitly disavowing the fee reduction. The SEC unanimously concluded that there was "no legitimate basis for the Commission to act as a 'rate-setter' and determine how much mutual fund customers should pay." In the Commission's view, "[t]his decision is better left to informed consumers, independent and vigorous mutual fund boards, and the free market."⁶¹ So, while state prosecutors can seek out expert advice, they do not necessarily take it.

But that raises the further question of whether the expert agency does, in fact, deserve deference. Regulatory agencies, despite their substantive knowledge, may not be in the best position to offer advice because their guidance could be driven by capture as much as expertise. If agencies are captured by the very groups they are charged with regulating and therefore less aggressive than they should be, it may be in the public interest for prosecutors to make an independent judgment whether and how to proceed. For instance, whether or not one agrees with the specific requirement of imposing a fee reduction, it does seem obvious that something needed to be done to address abuses in the mutual fund industry. Yet the

⁵⁸ Robert B. Ahdieh, *Dialectical Regulation*, 38 Conn. L. Rev. 863, 875 (2006).

⁵⁹ *Id.*

⁶⁰ Press Release, N.Y. Att'y Gen., Attorney General Cuomo Announces Doctor Ranking Agreement with Third Largest Health Insurer in U.S. (Nov. 13, 2007), available at http://www.oag.state.ny.us/media_center/2007/nov/nov13c_07.html.

⁶¹ SEC Press Release, Alliance Capital Management Will Pay Record \$250 Million and Make Significant Governance and Compliance Reforms To Settle SEC Charges, available at <http://sec.gov/news/press/2003-176.htm>.

SEC failed initially to address in *any* manner the problems of late trading and market timing in the mutual fund industry until Spitzer started putting pressure on the industry. Similarly, it was only after Spitzer exposed in detail the conflicts of interests between firms' securities analysts and underwriters that the SEC joined with Spitzer to create new rules for underwriters as part of a global settlement.⁶²

Many have observed that the SEC's reluctance was not the result of an expert decision but was instead the product of powerful lobbying that opposed SEC interference⁶³ and of a general sense at the SEC that, given the "rapidly revolving door between the SEC and private legal practice," "unless an issue has become high profile, it is best not to rock the boat."⁶⁴ The SEC had become "fully acclimated to existing market practices" and had staff members who "identified with the market participants they were ostensibly regulating."⁶⁵ Arthur Levitt, the chair of the SEC from 1993-2001 describes the SEC during his tenure as being constantly threatened by budget cuts if it pursued aggressive regulations because of corporate lobbying on the SEC's congressional overseers.⁶⁶ The result was an agency prone to lax enforcement – leaving a void that the NY AG's office filled.⁶⁷

In assessing the institutional competence of a prosecutor to regulate corporations, one must therefore balance competing concerns. On the one hand, substantive expertise is critical. On the other, even experts might end up with tainted views because of regulatory capture.

The fact, then, that prosecutors do not always defer to the judgment of experts is not necessarily a reason to condemn regulation by prosecutors. In some instances, prosecutors might be the ones with

⁶² John C. Coffee, Jr., *Corporate Securities*, New York Law Journal Mar. 20, 2008.

⁶³ John C. Coffee, Jr., *A Course of Inaction*, Legal Affairs 46 (Apr. 2004).

⁶⁴ *Id.*

⁶⁵ Jonathan R. Macey, *State-Federal Relations Post-Eliot Spitzer*, 70 Brook. L. Rev. 117, 128 (2004).

⁶⁶ ARTHUR LEVITT, TAKE ON THE STREET 123, 132 (2002)

⁶⁷ Even when the SEC did get involved in enforcement, it was not as aggressive as the NY AG in obtaining restitution for harmed shareholders. Eric Zitzewitz, *An Eliot Effect?: Prosecutorial Discretion in Mutual Fund Settlement Negotiations 2003-7* 1, 29 available at <http://www.dartmouth.edu/~ericz/eliot.pdf> ("settlement negotiations that involved New York as well as the Securities and Exchange Commission (SEC) resulted in restitution ratios that were higher by a factor of 5-10).

the necessary institutional competence because they have not been captured by industry. Because of the dynamics discussed above, this is unlikely to happen often because prosecutors may also find themselves concerned with placating powerful corporate interests. But there will be instances where prosecutors – either because they are federal prosecutors who are not beholden to a particular regulated entity or because they are in a state like NY and have a broad base of public support – can make regulatory decisions free of the biases of capture. In those instances, prosecutors might be serving as a valuable corrective to some of the accountability failures of agencies.

But it is worrisome if prosecutors are not seeking expert opinion as at least an input in their decisionmaking or if they are failing to give expert opinions sufficient deference when it is based on data and expertise. Instead of correcting problems with capture, prosecutors might in some cases make unwise and inefficient decisions because they are not properly trained to develop the right remedies.

C. *Procedural Reliability.* Accountability and expertise are not the only metrics for assessing regulatory policies. The methods used to reach decisions are also important. Prosecutors necessarily come to their regulatory policy decisions in the course of individual adjudications. Although a few agencies make policy decisions through that mechanism,⁶⁸ most agencies prefer to set policy through notice-and-comment rulemaking. That process is specifically designed for creating new rules of behavior. It allows input by all interested parties, not just those the prosecutor happens to charge or consult.

Indeed, even if a prosecutor consults with the relevant expert agency before reaching a decision, that agency will be operating at an informational disadvantage if it has not solicited and received comments on the issue. Regulators need detailed information about companies and their operation before crafting regulatory solutions, and the best way to obtain that information is to seek input from a

⁶⁸ Joan Flynn, *The Costs and Benefits of "Hiding the Ball": NLRB Policymaking and the Failure of Judicial Review*, 75 B.U. L. Rev. 387 (1995).

variety of sources. So, for example, even if an attorney general's office were to contact the SEC before fashioning a new rule for investment banks, the SEC itself may not know how best to proceed without feedback from the industry and other interested groups. The SEC has recognized this dynamic when it criticized Spitzer's fee reduction agreements with mutual funds, noting that it possessed "broad and unique rulemaking powers" and that "rules uniformly applicable to the entire industry are more desirable than a piecemeal approach that fragments the marketplace." In the SEC's view, any resolution of the fee issue should take place as part of a rulemaking process because that "is a better way to address fee issues than the imposition of arbitrary discounts in individual enforcement actions about market timing."⁶⁹

When agencies or prosecutors make policies in adjudications instead of rulemakings, there is also the danger that of insufficient oversight. The use of notice-and-comment rulemaking to change policies puts everyone on notice, including political overseers. This allows interested government officials the opportunity to weigh in before a regulatory shift occurs. Policymaking by adjudication takes place without advance warning to anyone other than the parties involved; by the time an agreement is reached, it is too late for others to weigh in.⁷⁰

Policymaking through prosecution is subject to even less oversight because it also evades judicial review. When agencies adopt regulations – whether in adjudications or rulemakings – they face judicial oversight to ensure the regulations are consistent with the agency's statutory mandate and are not otherwise arbitrary and capricious. The regulations in DPAs, NPAs, and other settlement agreements reached with prosecutors are generally not subject to judicial review.⁷¹ Prosecutors, unlike agencies, are therefore setting policies through procedures that make it difficult for interested parties to intervene and for political and judicial overseers to check abuses.

⁶⁹ SEC Press Release.

⁷⁰ Rachel E. Barkow & Peter W. Huber, *A Tale of Two Agencies: A Comparative Analysis of FCC and DOJ Review of Telecommunications Mergers*, 2000 U. Chi. Legal Forum 29, 77.

⁷¹ Garrett, *supra* note __, at 922-929.

Policymaking through adjudication raises other procedural concerns as well. There is a real danger that this approach to regulation will lead to disparate treatment of similarly situated companies because whether a new regulation applies to a corporation depends entirely on whom the prosecutor decides to target. Even if other companies have committed similar crimes, there is no guarantee that prosecutors will pursue them or, if they do, will seek the same terms for all violators. While agency adjudications suffer from the same shortcomings, agency rulemakings avoid these concerns with equity because these rules necessarily define the class of those effected, and judicial review ensures that the targeted group is based on a rational policy.

In recent years, the federal government has made an effort to make corporate regulation by prosecutors more uniform. In a series of memos circulated by deputy attorneys general, the Department laid out standards for AUSAs to follow when investigating companies and their employees for wrongdoing. But these memos fail to solve the fundamental equity problems because the memos are written in broad terms and there is no requirement that any particular company be charged or that the same regulations should be sought in all cases raising the same issues.

Moreover, another shortcoming to adopting regulations in settlement agreements is that the terms are not be subject to the kind of cost-benefit analysis that applies to most proposed rules. When executive agencies propose rules, they typically must explain to the President's Office of Manage and Budget that the benefits of the regulation outweigh the costs. Even independent agencies like the SEC often think about their proposed regulations in these terms because of statutory requirements.⁷² Decisions made in prosecutor's offices, however, undergo neither cost-benefit analysis nor any other kind of systemic review.⁷³

⁷² James J. Park, *The Competing Paradigms of Securities Regulation*, 57 Duke L.J. 625, 667 (2007).

⁷³ Miriam Hechler Baer, *Adjudication, Compliance and New Governance*

To be sure, there are some procedural advantages to setting regulatory policy in an adjudication. There is no concern with ossification or delay because the process is streamlined. The notice-and-comment process is notoriously time-consuming, and judicial and OMB review take even more time. In the case of companies that have engaged in criminal misconduct, delay in reforming their business practices could make recidivism more likely. Regulation by prosecutors can avoid this delay and also allow prosecutors to change practices easily in future cases if it turns out that a particular strategy is not working well.

But efficiency is not a sufficient reason to accept regulation by prosecutors. There must be some assurance that prosecutors are producing quality substantive regulations and evaluating them properly to ensure that they are appropriate. There is little in the existing procedures followed by prosecutors to give one much confidence on this score.

IV. Conclusion

The prosecutor as policymaker is not the Framers' vision, but it is increasingly the reality in many jurisdictions. This new role for the prosecutor sits uncomfortably with its institutional design. To be sure, prosecutors are relatively accountable for their decisions, but their procedures and structure are not ideally suited to make the complex judgments they are now making, particularly when entire industries are being reformed. There is no mechanism in place to seek out comment from a range of interested parties nor are prosecutors subject-matter experts in the areas in which they are regulating. To ensure that prosecutorial activism succeeds at improving public policy, then, greater attention must be paid to updating the prosecutor's office to better fulfill its new regulatory function. If prosecutors are going to behave like regulators, they should borrow from the best regulatory law has to offer.