



# Prosecutors Gone Wild

by Theodore H. Frank

ON MARCH 10, 2008, THE *New York Times* broke the story that New York's governor, Eliot Spitzer, was the unnamed "Client No. 9" listed in a federal indictment involving a prostitution ring called the Emperor's Club. Spitzer's bull-in-a-china-shop tenure as governor made him many enemies in both parties, so his unsuccessful term ended with his resignation just two days later to preempt an inevitable impeachment. Press coverage was still focused on details of the rendezvous at Washington's swanky Mayflower hotel, the role of the suffering-but-loyal wife in sex scandals, and the identity of the vapid *femme fatale* call girl, when the new governor, David Paterson, took office and dominated the news cycle with his own confessions of tit-for-tat extramarital affairs in the considerably less swanky Days Inn.

Spitzer's fall was so swift that the press barely got around to scrutinizing the tactics of the Department of Justice, quickly dropping the topic as it became yesterday's news. Prosecutors made it clear to the governor's attorney that Spitzer would be more likely to be indicted for a variety of technical financial offenses if he insisted on remaining in office, using the leverage of discretionary criminal charges to bypass the courts and get a resignation. Only one out of ten clients mentioned in the affidavit received particular attention. Client No. 9's sexual predilections and negotiations were described in humiliatingly prurient detail irrelevant to the underlying charges, his identity was leaked, and additional data about the governor's peccadilloes seeped out of the prosecutors' office over the course of the week. Prosecutors, without filing a single official document implicating Spitzer by name, forced him out of office. (In one of the few news stories to explore why the Department of Justice had engaged in extensive labor-intensive surveillance of Spitzer on multiple business trips, officials told the *New York Times* that

they were actually restrained because they didn't try to record the tryst or collect DNA evidence from the hotel room.)

Such tactics are not unique to the case of subject Eliot Spitzer. Indeed, a large deal of the gleeful *Spitzerfreude* on Wall Street arose from of the poetic justice of Spitzer's undoing at the hands of the same extra-judicial tactics he regularly used against Wall Street firms and corporate executives when he was attorney general of New York. The real scandal of Spitzer's career was not so much the former Girls Gone Wild model as the prosecutors gone wild.

The Spitzer *modus operandi* was a combination of bullying threats and demonization-by-press-conference-and-leak. A complacent media played along, partially because it was happy to portray Eliot Spitzer like his namesake Ness going up against Wall Street heavies, partially because it feared losing access to further juicy leaks in the competitive New York media market. Targets were expected to roll over and agree to settlements; they often did fairly quickly, at least after the first leaks from subpoenaed evidence started hitting the press. When they didn't, they were threatened privately and lambasted publicly in smear campaigns.

Spitzer used an obscure and broad New York law, the Martin Act, designed for prosecuting fraudulent high-pressure boiler-room sales operations, to go after Merrill Lynch. The Martin Act permitted Spitzer to subpoena Merrill Lynch in a fishing expedition without so much as filing a complaint against it. The company's stock price plunged as Spitzer launched public allegation after public allegation against it based on cherry-picked e-mails. With the risk of a state court order against it that would trigger a federal technicality prohibiting it from managing mutual funds, Merrill Lynch quickly ponied up \$100 million and let Spitzer dictate new regulations

for it rather than risk going out of business. Ten other firms followed suit, and suddenly, nationwide regulation of America's securities markets was being undertaken by the attorney general of the state of New York.

Sometimes the threats took the form of a more personal form of warfare, as when former New York Stock Exchange CEO Richard Grasso challenged Spitzer's power to dictate his severance package and Spitzer's office retaliated by leaking (as yet unproven) allegations that Grasso was having an affair with his secretary. In the words of New York Stock Exchange director Kenneth Langone, sued by Spitzer in the Grasso case, "Spitzer's methods are a perverse combination of duplicity and smear tactics."

When push came to shove, Spitzer's actual prosecutions often fell short. When H&R Block refused to give up \$30 million protection money in a settlement, Spitzer sued them for \$250 million. The press conference where Spitzer dragged Block through the mud got a lot of attention; the state court judge throwing the complaint out twice did not. The stock still hasn't returned to where it was before the indictment.

Like the prosecutors that eventually drove him out of office, Spitzer was not above using threats of prosecutions to achieve extra-judicial results. Spitzer publicly announced that he would refuse to negotiate with Marsh & McLennan insurance brokerage CEO Jeffrey Greenberg. That left the board of directors of Marsh, under investigation for rigging bids for policies, with no choice. An indictment would be a death sentence for the company. If the board did not fire Goldberg, then it could not settle with Spitzer, who would indict the company and send it under; individual directors could be potentially civilly liable to shareholders for billions. Greenberg was fired and replaced with a friend of Spitzer's, and a settlement was negotiated.

**O**THER STATE ATTORNEYS GENERAL have also abused their powers on behalf of campaign contributors, often aggrandizing the power of the office in the process. Trial lawyers siphoned billions of dollars out of state funds in the nationwide tobacco settlement. "Pay-to-play" arrangements where the attorney general turns over the keys to the office to campaign-contributor contingent-fee trial lawyers who bring lawsuits in the name of the state are all too common. Such suits are almost always litigated to benefit the private trial lawyer rather than the public policy goals of the state.

Rhode Island Attorney General Sheldon Whitehouse (now a senator) and his successor Patrick C. Lynch permitted the law firm Motley Rice (formerly Ness Motley) to bring litigation against companies that legally sold lead paint decades ago. State landlords, who are legally responsible for remediating and minimizing harm from lead paint, were ignored for fear that it would hurt the case against the deep-pocketed manufacturers. Similarly,

**A West Virginia attorney general refuses to turn over tens of millions of dollars of fines to the state treasury as required by law, and instead doles out the money as if it were a slush fund, often in regions where he needs a political boost.**

Motley Rice's theory of damages was calculated to maximize the attorneys' fees recovery by proposing an expensive and inefficient remediation program.

Motley Rice's theory of retroactive liability for the sale of a legal product is unprecedented and would have a tremendous adverse effect on the Rhode Island economy. No industry would be safe from clever pleading of a "public nuisance" from the unsavory aspects of its products. Indeed, we already see the first hints of this in California Attorney General Jerry Brown's lawsuit against the auto industry for selling vehicles that purportedly contribute to global warming.

The \$2 billion verdict against three manufacturers is on appeal to the Rhode Island Supreme Court and will likely be decided by the time this issue goes to press. We perhaps get a sense of the likelihood of long-term success from Motley Rice's decision to settle with defendant DuPont for only \$12.5 million. Most of that money never saw light of day in Rhode Island because millions of the award were given to a Massachusetts hospital with which Motley Rice had a relationship.

Attorneys general and federal prosecutors also use negotiations over defendant money for their own personal or political benefit. West Virginia Attorney General Darrell McGraw refuses to turn over tens of millions of dollars of fines to the state treasury as required by law, and instead doles out the money as if

it were a slush fund, often in regions where he needs a political boost or wants to return a favor. U.S. Attorney Chris Christie negotiated a deferred-prosecution agreement with Bristol-Meyers Squibb that required BMS to endow a chair at his alma mater—ironically enough, in ethics.

In the aftermath of Hurricane Katrina, Mississippi Attorney General Jim Hood appeared to be operating out of the offices of his trial-lawyer benefactor Dickie Scruggs. Scruggs brought litigation against State Farm seeking to extract additional money for hurricane damage not covered by existing insurance policies. Hood simultaneously threatened criminal prosecutions of State Farm executives. State Farm alleges Hood offered a quid pro quo to State Farm: settle with Scruggs, and there will be no criminal prosecution. State Farm capitulated, paying Scruggs tens of millions, and the prosecution went away.

Hood denies this, but performed poorly on the stand when questioned under oath about it in later litigation over his attempt to reopen the prosecution. He then agreed to a humiliating settlement dropping the prosecution rather than permit a judge to make findings that might confirm State Farm's allegations and grant an injunction. Now that Dickie Scruggs has pleaded guilty to attempting to bribe a state judge, one looks forward to whether the state will investigate the legality and propriety of the Hood-Scruggs relationship.

**A**LAS, WHEN THE EMPEROR'S CLUB allegations hit, Spitzer was already at a political low because of previous blunders. He lacked the political capital to stand up for himself and fight against prosecutorial abuse and overreach. The greatest sin in modern American politics is hypocrisy, so there was no personal profit for Spitzer to undo some of the harm he did as attorney general by speaking out against overzealousness.

Spitzer personifies that sort of overzealousness, but prosecutors up and down the legal system champion it as well. The joke is that "AG" in attorney general really stands for "Aspiring Governor," but lower-level prosecutors have their own aspirations. Federal Enron prosecutor John Kroger will be Oregon's next attorney general.

Demonizing a politically unpopular corporate figure is a surefire way to make a name for oneself. Conversely, prosecuting the beloved can be problematic. Thus, Apple's Steve Jobs is not prosecuted for

the same options-backdating violations that have ensnared less well-known Silicon Valley executives seeking to attract the best talent. As law professor Larry Ribstein writes:

Did Ken Lay, who was basically out of the picture until the very end at Enron, do more harm to the public and engage in conduct that was more obviously culpable than the principals at Krispy Kreme?... [A] government agency doesn't get the same goodies from going after a donut maker that it does from going after these people in Houston who have had movies made about them. When indictment decisions depend on considerations like that, it starts to look like a lottery.

Congress has provided the tools to ease the path for such prosecutorial ambitions. A criminal law against "theft of honest services" was intended for prosecuting bribery of public officials or the sort of kickbacks that Milberg Weiss arranged in its reign of terror in securities litigation. Instead, the law has been twisted beyond recognition to capture commonplace business transactions that prosecutors retroactively portray as sinister.

The prosecution of publisher and Hollinger International CEO Conrad Black provides a case in point. Because of a 1999 court ruling, Canadian tax law has a strange loophole where income received from a non-compete agreement is exempt from taxation. Attorneys for Hollinger realized that Black could avoid substantial tax liability from selling off a string of newspapers simply by re-characterizing compensation to Black and other Hollinger executives as payments for non-compete agreements. Money from third parties would go directly to Black instead of going to Hollinger and then to Black. Indeed, American buyers of the Hollinger properties received a small tax shelter for characterizing some of the purchase amount as Black's non-compete payments. Consequently these American buyers would be willing to pay more money overall because of the additional economic value of the tax shelter. The board of directors for Hollinger and its audit committee signed off on the payments.

Perhaps the Canadian tax authorities might have reason to complain that the transactions were sham; after all, in tax law, substance usually trumps form. Perhaps Hollinger shareholders might think the total compensation package given to Black and other executives was too high, and that the board

should have kept a tighter rein, and, indeed, minority shareholders sued Black and the former attorneys for Hollinger. But given the board's approval, and the lack of any accusation that Black enticed board members to breach their fiduciary duties to shareholders, it is hard to see why this internal corporate dispute should be a matter for prosecutors in Chicago.

Yet prosecutors charged Black and other Hollinger executives with theft of honest services and a variety of related crimes. The prosecution got around the board's approval by having a director on the audit committee testify that his written approval of non-compete agreements should be disregarded because he just "skimmed" the agreements and didn't remember any oral disclosure of them—a frightening prospect for executives everywhere if their freedom is contingent not upon the written record but upon a director's memory and the retroactive characterizations of a prosecutor.

During the trial, prosecutors belittled the idea of a media baron like Conrad Black demanding a purchaser of a small-town newspaper pay him not to compete. They treated the standard business practice of structuring transactions for maximum tax advantage as sinister. After a series of instructions that permitted the jury to find Black guilty without any finding of a violation of Canadian law or of loss to Hollinger, the jury split the baby, convicting Black for some of the non-compete agreements, but not others. Little consolation to Black, who faces six and a half years in prison and deportation if his conviction is not overturned on appeal, which is being argued this summer.

Black's best hope comes from the precedent of appellate courts intervening in the prosecutorial abuse of the Enron cases. The Fifth Circuit federal appeals court found that the Enron Task Force prosecutors stepped over the line in applying the "honest services" statute to four Merrill Lynch executives who handled a Nigerian-barge transaction with Enron that Enron allegedly then accounted for improperly. Their convictions were thrown out.

John Brownlee, U.S. Attorney for the Western District of Virginia, is another prosecutor who cares little about putting executives in impossible situations. Brownlee resurrected the "responsible corporate officer" doctrine, threatening three top executives of Purdue Pharma with prison time on the theory that executives could be vicariously liable for crimes committed by their underlings—regardless of whether the executives knew about or condoned the

crimes. In this case, low-level marketers understated the risks of OxyContin addiction to doctors, thus violating the Food, Drug, and Cosmetic Act's "misbranding" provision, as well as written Purdue policies.

As a compromise to avoid felony charges and prison, Michael Friedman, Howard Udell, and Dr. Paul Goldenheim pleaded guilty to a single strict-liability misdemeanor, and paid a total of \$34 million in fines—not much more than it would have cost to hire a top law firm to defend them at a lengthy trial. Unusually, the plea agreement explicitly acknowledges that the defendants do not agree that they had personal knowledge of the wrongdoing. The judge, in deciding to agree not to impose prison time, found there was no evidence that they did have such knowledge.

Such vicarious criminal liability, imposed upon anyone who has "the responsibility and authority to prevent or correct violations," is extraordinarily disturbing. Nothing in the statute restricts liability to top executives; middle managers are entirely at the mercy of prosecutors as well. And any pharmaceutical company with hundreds of sales reps is going to have a bad apple that maliciously or incompetently gives faulty information about a drug (or, more accurately, what a prosecutor thinks is faulty information about a drug), no matter how much oversight it provides.

Any drug company subjected to enough subpoenas will eventually cough up a technical violation in the haystack of the millions of subpoenaed documents. If courts condone such tactics, the liberty of every pharmaceutical executive in America will essentially be at the collective discretion of 93 U.S. Attorneys and their white-collar prosecutors. That is disturbing enough in the abstract, but absolutely frightening given that the next resident of the Oval Office, whether Republican or Democrat, will be someone who has scapegoated pharmaceutical companies on the campaign trail and is likely to have political appointments that share the view that the manufacturers of life-saving drugs are the "bad guys."

While Spitzer is gone, the overreaching tactics by which he made his name are not. So long as vague and broad criminal statutes give prosecutors nearly unlimited discretion to ruin lives, there will always be ambitious people who sit in the prosecutor's chair and misuse that power for their own gain. ❧

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**Theodore H. Frank** is a resident fellow at the American Enterprise Institute and the director of the AEI Legal Center for the Public Interest.