

“Supercharging” the Martin Act: The Schneiderman Wall Street Agenda

Commentary by Peter B. Pope, Jenner & Block

In less than one month, Attorney General-elect Eric Schneiderman is going to walk in the front door of his new office in lower Manhattan, take the elevator up to the 25th floor, and sit down for the first time at his desk as the new Attorney General of New York State. What he does next will have an enormous effect on the city, the state, the nation and, indeed, the world's markets. Schneiderman will be the next “Sheriff of Wall Street,” following in the footsteps of Eliot Spitzer and Andrew Cuomo. The voters have just given him the keys to what may be the most powerful securities regulation law ever written—New York State's Martin Act.

The new Attorney General clearly signaled his intentions during the campaign. He plans to be an aggressive enforcer. He says that he will work to keep New York the financial capital of the world, and believes that will be achieved in large part by assuring a level playing field for investors. He rues the loss of confidence that investors feel when they do not believe that the markets are fair, and has promised that he will bring enforcement actions that restore investor trust and draw capital back into the markets.

And it seems likely that Schneiderman will forge a more collegial working relationship with his federal counterparts than did his predecessors. A self-described progressive, Schneiderman is a strong admirer of the New Deal era of federal securities regulation who was dismayed at what he calls the

recent “de facto dismantling” of federal enforcement.

Schneiderman has talked specifically about his strategy. He plans large structural cases, like his predecessors, with a special focus on fraud in pension funds. He will institute a securities “whistleblower” program. And, perhaps most intriguingly, he will task his team of lawyers to marry the already strong powers of the Martin Act with the federal regulations being promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), especially those defining fiduciary duties.

“Supercharging” the Martin Act

In terms of the substance of Schneiderman's enforcement, New York should continue to expect large cases aimed at structural reform, designed to level the playing field for small investors. Schneiderman is a self-described “activist” who has explicitly promised to be an Attorney General in the Spitzer/Cuomo mold. There is every reason to believe him. And being a former big-firm litigation partner, he has the skill set to execute.

Schneiderman views it as a particularly important time for state enforcement. The federal system, he has pointed out, is in transition. The Dodd-Frank Act and other laws are creating a new set of federal rules, regulations, and even new agencies.

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Schneiderman believes that New York must be particularly vigilant as the new federal enforcement systems are adjusting to their new rules and new roles.

There are specific subject areas to watch. For one, the new Attorney General has said that he is carefully monitoring any new regulations that the federal government promulgates under the Dodd-Frank Act. Many commentators have suggested that the Securities and Exchange Commission (SEC) is poised to issue new regulations extending strict fiduciary duties to a broader range of players in the financial industry. Schneiderman has his eye on these, and has said that when they are issued he intends to use them to “supercharge” Martin Act investigations, which is somewhat akin to supercharging a nuclear bomb.

He is also prepared to go where federal law is wary of treading. In particular, Schneiderman has written that he is interested in how compensation systems for retail brokers may skew their recommendations to customers, that is, whether the compensation structure causes them to put their own interests ahead of their clients’.

If the new Attorney General follows this scent, the state will see significant investigations into retail brokerage houses, and whether the industry’s entire way of doing business leads inexorably to abuses. One of the tricks of the Martin Act is that it looks at practices not from what the industry intends, but from the effect that those practices have on investors. Basically, a Martin Act case is fraud from an investor’s-eye view. Freed from the burden of proving bad intent, Schneiderman could launch a potent industry-wide attack in fields like these.

The state is also likely to see enhanced enforcement in other financial product areas, particularly credit and insurance. As to the credit issues, Schneiderman is a big supporter of Elizabeth Warren, the new head of the federal Consumer

Protection Bureau. Expect to see an Office of the Attorney General (OAG) ambassador sent to Washington to work with Warren’s group on regulations and enforcement strategies. As Warren pursues her agenda to deploy technology and become a fierce data-driven watchdog, anticipate New York being there as a partner at every step.

And as to insurance, the Attorney General is likely to be particularly aggressive. It was a routine part of Schneiderman’s stump speech that New Yorkers are furious that the only thing that they get for paying insurance premiums is “standing to sue to collect their benefits.” Look for insurance cases early in the administration.

As to how he will make cases, expect Schneiderman to focus intently on whistleblowers. As a legislator he was a fervent supporter of incentivizing whistleblowers, and as an Attorney General he will undoubtedly seek to cultivate them. He has already said that he will seek new state laws to create additional incentives.

A Better Partnership with the SEC

In terms of the nuts and bolts of enforcement, a Schneiderman regime is likely to see a better working relationship between the OAG and the enforcement staff of the SEC than has existed for a decade. Eliot Spitzer once famously told the press that he would not trust the SEC to do a house closing, an observation which mightily dampened inter-agency camaraderie. And it is an open secret among New York white-collar defense counsel that the level of trust between the two offices only declined under Cuomo.

Schneiderman, in contrast, prides himself on building coalitions. He has a former legislator’s talent of bringing warring factions together to solve problems, and a natural inclination to accept help from all quarters. A perusal of his campaign policy book finds repeated promises to work collaboratively with other law enforcement groups,

government agencies, public interest groups, and neighborhood groups on a whole array of problems.

In addition, the new Attorney General has written that he genuinely admires the federal regulatory scheme as it was enacted, and credits it with truly effective governance of the nation's markets until its de facto dismantling in recent years. He is a big fan of the reinvigoration of the federal enforcement apparatus under President Obama, and is thus a natural SEC ally. So, as a practical matter, Schneiderman is likely to extend a hand of peace to the SEC, and they are likely to grasp it. This means that witnesses and subjects will no longer be caught between squabbling (or worse, racing) enforcers. There is no winning when two agencies are beating their chests about who can be more severe at a defendant's expense.

That is not to say that Schneiderman and the SEC will always agree. Of course they will not, and sometimes a state's enforcement interest can and will properly diverge from the federal government's. But reinstating simple civility between the agencies should restore a level of fairness to targets and witnesses that has simply been missing in the past few years.

Protecting New York's Tax Base

So Wall Street has yet a new sheriff, and one with an ambitious agenda. But there is another important side to Eric Schneiderman. Built into the DNA of this activist litigator is also a practical ex-legislator, one who understands how vital the financial industry is to New York's tax base.

Schneiderman often speaks about how government is a force for good, citing programs for better education and health care, and a better judicial system and environment. As a former elected official, he knows that these programs cost money, and that requires a strong tax base. And Schneiderman understands full well how vital the financial industry is to New York's tax base. If the

financial industry leaves the state, it will set back the social causes he so values.

Schneiderman has, consequently, promised that as Attorney General he will create a "Working Group" focused on keeping the finance industry in New York. Made of experts from the securities industry, academia, regulators, community groups, and homeland security, the group's mission will be to make sure that some other city overseas "does not become more attractive to investors and the financial industry."

So this much, at least, is clear. The Schneiderman enforcement agenda likely will not exploit populist rage for political gain, at least if it means no real reform and comes at the ultimate expense of taxpayers. How that plays out on a case by case basis over the next four years remains to be seen and is a tough balancing act to pull off.

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