NYSBA WINTER 2011 | Vol. 13 | No. 2

# Government, Law and Policy Journal

A Publication of the New York State Bar Association Committee on Attorneys in Public Service, produced in cooperation with the Government Law Center at Albany Law School

## The Oversight Function: Guarding the Public Interest

- Insurance Regulation
- Inspectors General in New York Municipalities
- New York City Department of Investigation
- Ethics Laws in New York State
- An International Trade "Watchdog"
- Private Incentives
- False Claims Acts
- Government Integrity
- Corruption Prevention and Government Efficiency

NEW YORK STATE BAR ASSOCIATION

*The Committee on Attorneys in Public Service*

# 2012 Annual Meeting Educational Programs and Awards for Excellence in Public Service

## Tuesday, January 24, 2012

## Hilton New York

Sutton Parlor North, 2nd floor, 1335 Avenue of the Americas (53rd-54th Streets) New York, NY

### Supreme Court Update

**(9:00 a.m. – 12:15 p.m.)**

This session will look back at the 2010-2011 term, the Justices, highlight the biggest decisions of the term and look ahead to the upcoming 2011-2012 term.

**Speakers:** William D. Araiza, Professor of Law, Brooklyn Law School
Jason Mazzone, Gerald Baylin Professor of Law, Brooklyn Law School

### New York Ethics Reform – Version 2.0

**(2:00 p.m. – 5:15 p.m.)**

**Moderator: Professor Patricia E. Salkin**

**Introductions:** 2:00 - 2:05 PM

**Panel # 1** — 2:05 - 2:55 PM
**Public Integrity Reform Act of 2011: What Every Government Lawyer and Lobbyist Should Know**

**Speakers:** Mark F. Glaser, Esq., Greenberg Traurig
Michael C. Fallon, Esq., Hinman Straub
Lisa P. Reid, Exec. Dir., NYS Legislative Ethics

**Break**: 2:55 - 3:10 PM

**Panel # 2** — 3:10 - 4:00 PM
**Investigation of Wrongdoing by Government Employees and Theft of Honest Services post *Skilling* — Sorting out Jurisdiction, Authority and What Actions of Employees are Covered**

**Speakers:** Karl J. Sleight, Esq. Harris Beach
Joseph A. Spinelli, Navigant Consulting
Hon. Richard A. Dollinger, NYS Court of Claims

**Panel # 3** — 4:00 - 5:15 PM
**Rules of Professional Conduct and the Government Lawyer**

**Speakers:** Richard Rifkin, Special Counsel, New York State Bar Association
Lisa F. Grumet, Esq., NYC Department of Law
Prof. Bruce A. Green, Fordham Law School
Kathleen Mulligan Baxter, General Counsel, New York State Bar Association

## 2012 Awards for Excellence in Public Service Reception

**(5:30 p.m. - 7:00 p.m.)**

**2012 Honorees: Stephen G. Brooks, Bennett M. Liebman, Hon. Marian W. Payson and Carol L. Van Scoyoc**

**Committee on Attorneys in Public Service:** Peter S. Loomis, Chair

**Annual Meeting Planning Committee:** Catherine Christian, Anne Murphy and Patricia E. Salkin

**Awards Committee Chairs:** Donna M. Giliberto and Theresa L. Egan

**This Award Reception is a FREE event, and is open to all NYSBA members, friends and colleagues**

RSVP by January 20, 2012 to: caps@nysba.org or 518-487-5571.

NYSBA
Government, Law and Policy Journal



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# Contents



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# Message from the Chair

By Peter S. Loomis

Fall has begun as I write this message, and the Committee on Attorneys in Public Service (CAPS) has begun what is expected to be a busy year. We have a number of new members representing a wide variety of public sector interests, and I am excited about the months ahead. Fall is traditionally a particularly busy time for the Committee, as we plan our program for the Association's Annual Meeting in January and select our honorees for the Association's Award for Excellence in Public Service.

Our Awards and Citations Subcommittee, chaired this year by Donna Giliberto and Terri Egan, reviewed the record-setting 24 nominations the Committee received for the annual Award for Excellence in Public Service, and the full Committee chose our honorees in mid-October. This will be the thirteenth year that we have singled out individuals and, in a few cases, offices or organizations, as representing the very best in public service in New York. Our award criteria state that "Individuals must epitomize a commitment to the highest and noblest calling afforded by the legal profession: to preserve and protect the public," and that "…their efforts must demonstrate a commitment to service, honor and integrity." Some of our past honorees have been well known to the public and others have been known for their dedication to excellence perhaps only by their coworkers or those who benefitted from their work, but each honoree chosen by CAPS has been recognized because of an extraordinary level of service to the public good. Our 2012 honorees for 2012, to be honored at the annual Bar Association meeting in January in New York City, are Stephen G. Brooks, Bennett M. Liebman, Hon. Marian W. Payson, and Carol L. Van Scoyoc.

Also very active this fall is our Annual Meeting Subcommittee, chaired by Catherine Christian and Anne Murphy. The morning program in January will continue our tradition of an annual Supreme Court review, which has always been well received, and we will be honored once again to have with us two distinguished professors from Brooklyn Law School, Jason Mazzone and William Araiza. Our afternoon programs have always tackled issues of current interest to public sector attorneys, and 2012 will be no exception, as we look at the current state of Ethics Reform in New York. Our impressive list of speakers continues to grow at this writing, and includes such experts as Mark Glaser, Karl Sleight, Judge Richard Dollinger and Bruce Green. More are soon to follow. The afternoon program will be moderated by Professor Patty Salkin of Albany Law School who, as our readers will recall, is a past CAPS chair and was a co-chair of past NYSBA president Steve Younger's Special Task Force on Government Ethics.

The topics of Ethics is particularly relevant for this year's program in light of the Public Integrity Reform Act of 2011 and also because this Winter 2011 issue of the *Government, Law and Policy Journal* is dedicated to the oversight function and issues involving guarding the public interest. With Dan Feldman serving as Guest Editor, the *Journal* contains 12 articles addressing a variety of topical issues, and I sincerely thank Dan and our contributing authors for producing another quality product. Thanks as always also go to Editor Rose Mary Bailly and the students at Albany Law School who edited the articles. As I have said in prior Messages, production of the *Journal* is one of CAPS' proudest achievements, and these issues could never be published without our ongoing partnership with the Government Law Center at Albany Law School, led by Patty Salkin. Kudos to all!!

# Editor's Foreword

By Rose Mary K. Bailly

Dan Feldman, the Guest Editor for this issue of the *Government, Law and Policy Journal*, invited a number of scholars and experts to examine the efficacy of oversight at all levels of government from the local to state to federal to international. We are grateful to Dan for introducing us to the possibilities and challenges in government accountability.

I would like to especially thank our Executive Editor for 2011-2012, Daniel Levin, Albany Law School, Class of 2012, for his professionalism, enthusiasm and organizational skills. He and his Albany Law School colleagues, Alaina Bergerstock, Oriana Carravetta, Stefan Eilts, Jennifer Jack, Kevin Rautenstrauch, Stephanie Sciandra, Adam Staier, Catherine Van Auken, all of the Class of 2012, worked efficiently to produce this final product. As always, we were in the capable hands of the staff of

the New York State Bar Association, Lyn Curtis and Wendy Harbour, for their expertise and enduring patience. And last, my thanks to Patty Salkin for her inspiration and support.

Finally, I take full responsibility for any flaws, mistakes, oversights or shortcomings in these pages. The errors are entirely my own. Your comments and suggestions are always welcome at rbail@albanylaw.edu or at Government Law Center, 80 New Scotland Avenue, Albany, New York 12208.

## Errata

My apologies to James M. McGuire, Esq. for two grammatical errors that appeared in his article *Pataki v. Assembly: The Unanswered Question*, 13 Government, Law and Policy Journal 11, 13 (Summer 2011).

The text at page 13, note 33 should read:

> The concurrence writes that "[t]he clause was designed to preserve the separation of powers,"[33] as if to suggest that the clause furthers the legislature's preeminence.

The text of endnote 34, at page 16, should read:

> I do not mean to suggest that I agree with the concurrence's unstated premise that the "Legislature's lawmaking preeminence" was unaffected by the transfer of legislative powers to the Governor effected by the adoption of executive budgeting. To the contrary, as discussed below, I think it untenable.

# Guest Editor's Foreword

By Daniel L. Feldman

We are greatly indebted to the outstanding scholars and practitioners whose contributions have made this issue of *Government, Law and Policy Journal* a gold mine for those committed to the pursuit of integrity in public administration (not, *pace* Anechiarico and Jacobs, the pursuit of **absolute** integrity!).

> *"I have had the pleasure of the company of these thoughtful essays for a few months. It is now my privilege to share them with you."*

I am to blame for unbalanced attention to insurance regulation issues, having selected that particular policy area as our chief illustration. Banking regulation issues have occupied the front pages of serious newspapers since 2007, so here we have only half an article on banking regulation but two-and-a-half different "takes" on insurance, the banking industry's most serious competitor for problematic treatment of consumers. Bob Hunter's masterful review of the state of state insurance regulation offers a how-to for those who would transform this perennially pathetic excuse for oversight into real protection for insurance policy holders. Amy Bach and Peter Kochenburger explain how vigorous consumer organizations and private actions can force state regulators actually to regulate. Mark Peters and Mohana Terry, with a very different perspective, argue that New York's new Department of Financial Services will enhance and improve the regulation of both banking and insurance in our state.

Our contributors assess the efficacy of oversight at the city, state, federal, and international levels of jurisdictional and geographical magnitude: Phil Zisman reports on the possibilities and limitations of oversight in small and mid-sized cities, and Rose Gill Hearn reports on the possibilities and limitations of oversight in a very large city indeed. Blair Horner and Russ Haven set forth the history of New York State's ethics oversight efforts, Betty Vega uses her experience with the Navy to show how inspectors general exercise oversight at the federal level, and Cecilia Gardner describes the workings of the Kimberley Process, a unique international oversight mechanism that largely succeeded in excluding from the stream of commerce the "blood diamonds" from Angola and Sierra Leone that made news in the 1990s.

Two of our articles show how the profit motive can be harnessed in service of oversight and integrity. Ron Goldstock explains the workings of IPSIGs, those private-sector, profit-making entities that ensure the otherwise questionable integrity of the very companies that must pay them, when the government entities that need the services of such companies or the prosecutors or judges who want alternatives to prosecuting or sentencing them, require them to hire IPSIGs as a condition of their contracts or of those alternatives. Gene De Santis and Reannon Froehlich discuss the various versions of the False Claims Act, which provide bounties to private citizens who bring successful lawsuits to recover funds from those who have defrauded government.

Frank Anechiarico and Dennis C. Smith, in a coda fifteen years after the 1996 publication of *The Pursuit of Absolute Integrity*, the rather skeptical review of New York City's anticorruption efforts by Anechiarico and James Jacobs, conclude that the City has now gotten much closer to "doing it right." In a somewhat complementary essay, David Eichenthal, by offering highly intriguing correlations between economic development and apparent advances in corruption control in four archetypical United States cities, launches a powerful rejoinder to those critics like the late Samuel Huntington and the 1996 Frank Anechiarico who have questioned the value of anticorruption efforts in certain contexts.

I have had the pleasure of the company of these thoughtful essays for a few months. It is now my privilege to share them with you.

**Daniel L. Feldman is Associate Professor of Public Management at John Jay College of Criminal Justice, a college within the City University of New York. He teaches Ethics and Accountability, Oversight and Investigation, and Policy Analysis.**

**Elected to the State Assembly from the 45th district in Brooklyn in 1980, between 1981 and 1998, Mr. Feldman authored over 140 laws, including New York's Organized Crime Control Act and New York's Megan's Law. As Correction Committee chair for twelve years, he led some of the first efforts to repeal the Rockefeller drug laws.**

**From 1999 to 2005, on the senior staff of Attorney General Eliot Spitzer, he initiated or contributed significantly to litigation against handgun manufacturers, a major real estate fraud investigation, and significant set-**

tlements with prominent banking and insurance companies, while advising the Attorney General on criminal justice legislation and election reform. Subsequently, as Executive Director and General Counsel to the New York State Trial Lawyers Association, he oversaw research, lobbying, finance, legal education, business relationships, a $5 million annual budget and a 22-member staff. Then, as Special Counsel for Law & Policy from 2007 to 2010, Mr. Feldman advised the New York State Comptroller, Thomas P. DiNapoli, on a wide range of issues including investment policy, economic development, supervision of outside counsel, Retirement System hearings, and the administration of the unclaimed funds program.

A graduate of Columbia College and Harvard Law School, since 1977 Mr. Feldman has taught law, government, and political philosophy at various prominent universities in the northeast, and lectured on jurisprudence at Oxford University in 1982 and 1990. His first book, *Reforming Government*, was published in 1981, and his second, *The Logic of American Government*, in 1990, both by William Morrow & Company. He was Legislative Editor and co-author of a third book, *New York Criminal Law*, published by West Publishing Company in 1996. He wrote his fourth book, *Tales from the Sausage Factory*, with co-author Gerald Benjamin, published by the State University of New York Press in September 2010. Feldman's articles on American law and government have appeared in numerous scholarly and professional journals, and he served as a member of the Editorial Board of *Public Administration Review* from 1992 to 2000.

# A Failure of Oversight in Need of Rescue: Insurance Regulation

By J. Robert Hunter

This article reviews the four main reasons why state insurance commissioners rarely succeed in adequately protecting consumers: lack of authority, lack of will, lack of resources and lack of sufficient power to balance the overwhelming influence of the insurance industry at the state level.

Based on my 50 years of experience as a federal and state regulator, a consultant to state and federal regulators, an industry actuary, an expert witness and a consumer advocate, I understand the pressures on commissioners and the courage it takes to do the right thing for consumers, given the tremendous power of insurance companies and agents. After looking at the challenges the nation's insurance commissioners face, I propose some ideas to help balance the scales so that consumers of insurance are better served.

## Background

### The Impact and Importance of Insurance in America

#### Annual consumer expenditures

In 2009, Americans spent $1,787 billion on private insurance: $655 billion to life and health insurers, $567 billion to pure health insurers, $457 billion to property/casualty insurers, $9 billion to fraternal insurers, $9 billion to title insurers, $82 billion to captive insurers and $9 billion to other types of insurers.[1] This includes the premium cost of insurance purchased by businesses. However, since businesses pass this cost on to consumers, this amount is included in the estimate.

The average American household spent $15,599 on insurance in 2009.[2] In that year, the personal disposable income in America was $11,035 billion.[3] Insurance expenditures, therefore, represented 16.2 percent of America's disposable income. (Looking just at premiums paid directly by consumers, or on their behalf by employers as a benefit, the total in 2009 was $1.1 trillion, or $10,476 per household—9.5 percent of disposable income.) Research suggests that this percentage is even higher for low- and moderate-income Americans who, more frequently than others, end up uninsured because they simply cannot afford the coverage.

The federal government's Consumer Expenditure Survey suggests, for example, that auto insurance coverages alone are very expensive, costing LMI households $36 billion in premiums in 2009. This expenditure dwarfs LMI spending of $5 billion for automobile financing and $6 billion for life insurance and other personal insurance premiums in the same year. It also greatly exceeds the estimated $9 billion in payday loan interest and fees paid by all consumers the previous year. LMI auto insurance premiums were even about three-fifths of the amount of all LMI spending on mortgage financing ($55 billion) in 2009.[4]

*"[There are] four main reasons why state insurance commissioners rarely succeed in adequately protecting consumers: lack of authority, lack of will, lack of resources and lack of sufficient power to balance the overwhelming influence of the insurance industry…."*

Insurance is vital to living a normal life in 21st Century America. Auto insurance is required by states to drive a car, or by banks to finance a car. Home insurance is required by lenders to finance a home. Every American needs health insurance to cover the risk of illness in today's high-cost environment. To assure that a child or other dependent is cared for in the event of the death of a breadwinner, life insurance is also essential.

#### Insurance regulation

The U.S. insurance regulation system developed in the early 1800s when frequent insurance company failures and abusive treatment of customers persuaded states to establish commissions to regulate the industry. In 1871, states created an organization that became the National Association of Insurance Commissioners (NAIC) to better coordinate their efforts. The states regulated the industry until 1944, when the U.S. Supreme Court ruled that insurers were subject to federal regulation, including, for the first time, antitrust law.[5] In response, Congress passed the McCarran-Ferguson Act[6] in 1945, which not only delegated most insurance regulation to the states, but also granted an antitrust exemption to insurers.

There is no serious debate about whether the insurance industry should be regulated. Its essential role in the economy, its importance for consumers, the dependence of customers on its solvency, and the difficulty that individuals have in evaluating the value of complex policies, help explain the broad consensus on the need for regulation. Even those arguing for rate deregulation accept the need for regulation of solvency, market conduct and other matters.[7]

## The Four Major Challenges to State Regulation of Insurance

### Challenge #1—Excessive Industry Influence on Legislation

### Dominant insurance industry lobbying and campaign spending

In 2002, the Center for Public Integrity found that "the insurance industry had the largest number of lobbying organizations nationally with 2,269."[8] In 2005, it reported that the insurance industry "spent more money to sway public policy" than any other industry.[9] "In 2007 and 2008, the insurance industry contributed a record $46.7 million" to federal elections, according to the Center for Responsive Politics. It calculated the average contribution from the industry to members of Congress over the 1990-2010 period. In 1990, Republican House members received an average of $18,000, which rose to $49,000 by 2010. Democratic members got a bit less, about $13,000 in 1990, which rose to $38,000 by 2010. Republican and Democratic Senators both got $30,000 in 1990 but the largesse to Republicans rose faster over the years so that in 2010 Republican Senators got an average campaign contribution from the insurance industry of $78,000 whereas the Democrat Senators got "only" $59,000.[10]

Industry spending has had a huge impact on the national health care debate, from the days of "Harry and Louise" advertisements in 1994 until now. Lobbying by the insurance industry stopped efforts to give the new federal Consumer Financial Protection Bureau authority over credit-related insurance. Industry lobbying at the state level has effectively promoted a broad deregulation agenda for a number of lines of insurance, keeping rates too high in many cases, especially for credit-related insurance, such as credit insurance and forced-placed coverage.

Under lobbying from the industry, state regulators have consistently put the interests of insurers above the needs of consumers. Consider some of these failures to act by the NAIC:

1. Failure to do anything about abuses in the small face life market. Instead, NAIC adopted an incomprehensible disclosure on premiums exceeding benefits, but did nothing on overcharges, multiple policies, or unfair sales practices.

2. Failure to do anything meaningful about unsuitable sales in any line of insurance. Suitability requirements still do not exist for life insurance sales even in the wake of the remarkable market conduct scandals.

3. Failure to call for collection and public disclosure of market performance data after years of requests for regulators to enhance market data, as NAIC weakened consumer protections.

4. Failure to call for repeal of the antitrust exemption in the McCarran-Ferguson Act as it pushes forward deregulation model bills. Indeed, the NAIC still opposes repeal of the antitrust exemption even as it deregulates, effectively seeking to deregulate cartel-like organizations.

5. Failure to do anything as an organization on the use of credit scoring for insurance purposes.

6. Failure to address problems with risk selection. There has not even been a discussion of insurers' explosive use of underwriting and rating factors targeted at socio-economic characteristics: credit scoring, check writing, prior bodily injury coverage limits purchased by the applicant, prior insurer, prior non-standard insurer, education, occupation, not-at-fault claims, not to mention use of genetic information, where Congress has had to recently act to fill the regulatory void.

7. Failure to even discover, much less deal with (except for one of many insurers using such systems), the claims abuses relating to the use of computerized systems designed to systematically underpay claims for millions of Americans.

8. Failure to do anything on single premium credit insurance abuses.

9. Failure to take meaningful action on conflict-of-interest restrictions even after Ernst Csiszar left his post as South Carolina regulator and President of the NAIC in September 2004 to become President of the Property Casualty Insurers Association of America after negotiating deregulation provisions desired by PCIAA members.

### Industry executives on key state legislative committees

After a four-month, 50-state study, *Money Magazine* found that:

> [t]hough insurance industry employees make up less than 2 [percent] of the American work force, at least 15 [percent] of the state lawmakers who serve on committees overseeing insurance legislation are insurance agents or company executives, or are otherwise connected to the industry. In 12 states, legislators linked to insurers make up more than 20 percent

> of such committees…in at least 16 states those legislators with industry connections serve in positions of authority such as chairman of an insurance committee.[11]

A study I had done a few years earlier for the National Insurance Consumer Organization showed similar results. I have not updated this work, as it represents a significant expenditure of time and resources, but, as reported below, I did do an update on an important sample of state legislators, which showed that the problem has not been resolved.

The National Conference of Insurance Legislators (NCOIL) is the leading state legislative group focused on insurance. On its web site, NCOIL states that its purpose is to "help legislators make informed decisions on insurance issues." It frequently takes positions on high-profile insurance issues that are favorable, if not identical, to insurance interests. These positions have frequently undermined consumer protections.[12]

NCOIL is made up of legislators from just about half of the states, many of whom are full-time employees of the insurance industry. The five current top executives of NCOIL include two persons (the president-elect and the treasurer) who are insurance industry employees. The current executive committee is made up of 60 people, 20 of whom (33 percent) currently work for the insurance industry as agents, company executives or attorneys with firms that have insurance clients. Additionally, it is unclear if 18 others (30 percent) have insurance ties or not. (These people have occupations that can have insurance components, like banking and real estate brokerage, or they have not disclosed their employment). Only 22 (37 percent) are, based on their occupations, clearly not currently employed directly or indirectly by the insurance industry.[13]

This industry dominance of NCOIL is not new. A 2003 study I conducted for the Consumer Federation of America concluded, "at least 40 percent of the leadership of NCOIL have worked for or with the insurance industry."[14]

### Challenge #2—Lack of Will

#### Impact of state legislature on the commissioner

When I was Texas Insurance Commissioner, one of the most startling things I discovered was the day-to-day pressure coming from the state legislature, especially from legislators employed in the insurance business. My first day on the job, a state legislator with great influence over the operation of the department asked me to fire two employees. It turned out the legislator was an attorney representing an insurer who was seeking, unsuccessfully (for cause), to get licensed. That was unusual, but it was usual for legislators to place constant and withering pressure on the department to do something that legislator's constituent (or even employer) insurance company wanted done.

A major study of state regulation determined that the most critical relationship for commissioners was "the one with the state legislature…Commissioners scored the power bases of each constituency using a 10-point scale from 1 = 'almost no extent' to 10 'a very great extent.'"[15]

| | All |
|---|---|
| State Legislature | 7.3 |
| Individual Insurers | 4.8 |
| Agent's Associations | 4.6 |
| Media | 4.6 |
| NAIC | 4.4 |
| Industry Trade Groups | 4.3 |
| Consumer Groups | 3.5 |
| Federal Actors | 3.3 |

#### Impact of lobbying on the commissioner

My experience as insurance commissioner also taught me that there is essentially no counterbalance to industry pressure, whether from the legislature or from insurance agents (who have a fantastic ability to reach every legislator right where they live, with one or more small businesspeople from every town in the legislator's district).

Consumer groups dealing with insurance do not exist in most states and, even in the few where they do exist, such as California, New York and Florida, the groups are very understaffed and working on other matters, so that they can only take on a few insurance issues at most. Every day, the Texas Department had a line of insurance executives coming in to ask for something. If a consumer group or individual came in to lobby, it was rare.

Elected commissioners might be expected to be more consumer-friendly, given that they have to get votes. This might be true if the campaign finance system wasn't so one-sided. Currently, many commissioner candidates take significant insurance contributions, which at least gives the appearance (if not the fact) of industry bias. Recent examples of elected commissions who received their greatest campaign support from insurance sources are Georgia Commissioner Ralph Hudgens ($149,402) and Kansas Commissioner Sandy Praeger ($208,792).[16]

Moreover, state regulations in all states except California incentivize this campaign giving. Insurers can pass through to consumers the cost of all lobbying and campaign donations as an element of the premiums they charge.

#### The "revolving door"

The consumer organization Consumer Watchdog recently reported that "24 of the state insurance commissioners worked for the insurance industry before being appointed and two were elected with insurance industry campaign contributions."[17] Thus, about half of regulators have industry experience and potential bias. The number has been constant for decades:

> GAO found that insurance regulation is not characterized by an arms-length relationship between the regulators and the regulated.
>
> While the extent of the "revolving door" problem may be overstated by critics of State regulation, about half of the State insurance commissioners were previously employed by the insurance industry and roughly the same proportion joined the industry after leaving office.[18]

Since 2000, six past presidents of the NAIC have become lobbyists for the insurance industry.[19] Two left the position to jump straight into insurance industry lobbying jobs.

A prominent revolving door situation was that of Ernst Csiszar, South Carolina's Insurance Commissioner from 1999 to 2004, and President of the NAIC in 2004 when an astonishing series of events took place. There was a deregulation bill before Congress that would have preempted state consumer protections, only allowing states to deviate if they *reduced* already inadequate protections. When I was discussing the problems with the bill with a key Congressman in the spring of 2004, I was advised that the President of the NAIC, Mr. Csiszar, had advised him that the NAIC supported the bill. This surprised me, since I knew the NAIC had not taken a position like that in its deliberations. Consumer Federation of America and other consumer groups issued a press release in which I said "Csiszar favors broad deregulation of many aspects of insurance. His views are on the extreme end of the spectrum of views of members of the NAIC…(our) concern is that Director Csiszar is using his position as NAIC President to push his extreme views instead of the consensus positions taken by the NAIC. Despite his position as NAIC President, Commissioner Csiszar has pledged to abandon NAIC work products in favor of other organizations' work that are more in line with his personal agenda." We called on Csiszar to resign as President of the NAIC for misrepresenting the organization's views. The next day, the *New York Times* quoted Mr. Csiszar's response as follows: "'I have absolutely not abandoned state regulation nor any N.A.I.C. established policies."[20] I sent a letter to all 51 insurance commissioners saying that President Csiszar was misrepresenting the NAIC position on the anti-consumer federal bill. I then traveled to the NAIC's convention in New York on March 13-16, 2004. At that meeting I was publicly chided by the leadership for attacking their President but privately they thanked me for letting them know that their position had been misrepresented. Later that month, President Csiszar testified before the Financial Services Committee, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (accompanied—I think chaperoned—by other regulators). There he had to change his deregulation tune and say what the actual NAIC position was on deregulation: "we do not believe a single national rating or product regulation model for personal property casualty insurance lines is appropriate or feasible, whether imposed by the states or the federal government. The significant differences in risks and local conditions from one state to another produce challenges to a "one size fits all" regulatory approach for such essential products as homeowners and auto insurance."[21] It was not long, less than five months, until Ernst Csiszar resigned from both the NAIC presidency and the South Carolina Insurance Commissioner jobs to become President of the Property Casualty Insurers Association of America after attempting to surreptitiously negotiate deregulation provisions of the sort desired by PCIAA members. At the time I said his departure was "a good day for consumers--the sheep's clothing is off the wolf. We called for his resignation months ago."[22]

CFA's calls on the NAIC to adopt ethical rules to control the revolving door have gone unanswered.

**Misunderstanding of role—Most commissioners see their role as judicial, but only one side presents a case**

A Harvard professor and a Harvard doctoral student undertook a very important study of state insurance regulation in 1983.[23] After intensive study, they came to a conclusion that is one of the keys to understanding the failure of state regulation to more adequately protect consumers: the regulatory philosophy of the majority of commissioners is not to intervene on behalf of consumers.

The study included meetings with officers of the National Association of Insurance Commissioners, detailed interviews with a national cross-section of commissioners and their staffs, and a written survey. In the initial meetings with state commissioners, the authors thought that there seemed to be

> two regulatory philosophies… Some commissioners appeared to place more emphasis on the public interest and to be more active in pressing for industry responsiveness to insurance-related public policy issues than others… Other commissioners identified with a more balanced view of the role of an insurance regulator, one where he or she does serve as an arbiter between the interests of the public and those of the industry… We labeled these different roles the *activist* and the *arbiter*… The most important preliminary finding was the possible coexistence of two distinct regulatory philosophies. (Emphasis in the original).[24]

The preliminary findings were confirmed by the National Survey of State Insurance Commissioners, the only such survey ever undertaken by independent researchers.

The survey response was good, with complete responses to a lengthy questionnaire from 34 states (sixty-three percent of the nation's states and other jurisdictions to which surveys were sent).

The key finding was that "38 percent identified with the public-interest philosophy of the activist, whereas 62 percent identified with the political-economy philosophy of the arbiter."[25] The reason this is a key factor in the failure of states to protect consumers is that a philosophy of arbitration (i.e., a judicial philosophy) is not workable in the insurance context because a judicial decision must rest on vigorous input from the two parties in interest. This situation is virtually non-existent in insurance. The arbiter almost always arbitrates after hearing primarily from only one side. Such an approach favors the side bringing virtually all of the input and lobbying pressure.

When I first read *The Regulatory Executives* in early 1984, I thought that thirty-eight percent of the commissioners viewing their role as one of an "activist" overstated the actual number of activist commissioners. First, it is almost certain that the seventeen commissioners who did not fully respond to the survey were all or almost all "arbiters." If these commissioners were indeed "arbiters," the proportion of "activist" commissioners would drop to a more believable twenty-five percent.

Since 1983, I am sure that the number of activist commissioners has fallen sharply after decades of anti-regulation rhetoric, much of it from the industry (either directly or through academics with industry funding). Consumers of insurance are much more at risk of soft, inadequate regulation today than they were thirty years ago.

## Challenge #3—Lack of Resources—The Uneven Playing Field (Part 1)

### State Insurance Department resources are inadequate

Every year, the NAIC publishes its Insurance Department Resources Report. The report contains statistics on the resources and regulatory activities of the members of the NAIC, which include the 50 states, the District of Columbia and five territories.

Listed below are some of the key facts gleaned from the 2009 version of the report,[26] followed by an analysis that shows that state regulators are understaffed and inadequately funded.

- In 2009, the total insurance department staff in America was 11,590. Among the states, the largest staff was in Texas (1,693) and the smallest was in Wyoming (27). The top five states (Texas, California, Florida, New York and North Carolina) had almost half (49 percent) of all staff in the nation. Most states have inadequate staff.
- In terms of quality of staff, there were 463 lawyers in state regulation in 2009, with no lawyers in four states (Alaska, Colorado, Idaho and Iowa). Seven states had only one lawyer. California had 80 lawyers. The average state had about 8 lawyers.
- There were 129 life/health actuaries and 89 property/casualty actuaries in state regulation in 2009. This represents a little more than two life/health actuaries and one property/casualty actuaries per state. In comparison, Prudential Insurance has 287 actuaries; Travelers has 204; Aetna 120; Allstate 147, New York Life 239; Liberty Mutual 172, American International 145, and State Farm 111.[27] Sixteen states had no life/health actuary and 18 states had no property/casualty actuary in 2009.
- There were 799 financial examiners (14 per jurisdiction) and 347 market conduct examiners (six per jurisdiction) employed by state regulation in 2009. Nine states had no financial examiners and 13 states had no market conduct examiners.
- There were 591 complaint investigators in 2009 (11 per jurisdiction). Five states had no complaint investigators.
- There were 49 consumer advocates (under one per jurisdiction) in 2009. Thirty-eight states had no such staff. Only one state had a consumer advocate for insurance outside of the commissioner's office. This lack of independence, combined with too few advocates, makes effective advocacy on behalf of consumers very difficult.
- In some states, salaries for certain professional staff are very low. For example, the *high* salary for lawyers is $55,002 in Tennessee and $62,000 in Indiana and Kansas. The *high* salary for an actuary in Tennessee is $56,664. The *high* salary for market conduct examiners is under $50,000 in Kansas. Many states have salary levels inadequate to attract highly qualified staff.
- Total budget for the regulation of the insurance industry was $1,595,081,240 in 2009. That is less than 0.1 percent of the $1,787 billion Americans paid for insurance. In 2011, the budget projected for state regulation will be $1,773,083,740, still less than 0.1 percent of what Americans pay for their insurance. If budgets were doubled and the cost passed through to consumers in premiums, the impact on rates would be negligible.
- In 2011, the top four states in budget (New York, California, Texas and Florida) will spend 53 percent of the total spent by all states and territories. The average jurisdiction overall spends almost $32 million regulating insurance, but that figure falls in half, to about $16 million when the top four states are removed from the calculation. The median jurisdiction will spend about $13 million in 2011.

- Nationally, there are 7,869 insurers domesticated in the states. New York has the largest number of domestic insurers, 617, followed by Florida, Vermont, Texas and Wisconsin. The average jurisdiction has 141 domestic insurers. This is important since other states usually look to the state of domicile to be the first line of regulation for a particular insurer.
- States also regulate insurers licensed to do business in the state, but not domiciled there. These are known as "foreign" insurers. The average number of foreign insurers per state is 1,292, ranging from a high of 1,689 in Virginia to a low of 743 in Alaska.
- Measures of the work performed by regulators include examinations completed, actions against companies and producers, formal hearings that are held, supervisions, receiverships and run-off of insurers in financial trouble, and the handling of consumer complaints and inquiries.
- In 2009, state regulation completed 2,448 examinations of insurers, consisting of 1,312 financial exams, 735 market conduct exams and 401 combined financial and market conduct exams. California completed the most exams, 267 (60 financial and 207 market conduct); Wyoming completed two (financial). Of the 1,312 financial exams completed nationally, all but 6 were of domestic insurers. Of the 735 completed market conduct exams, 479 were of foreign insurers, and 256 were of domestics.
- 207 insurers had their certificates of authority suspended and 50 had their certificates revoked in 2009. The largest number of suspensions was in Kentucky (22). Twenty-two states did not suspend any insurers. The largest number of revocations was in South Carolina (10); 37 states did not revoke any certificates.
- There are 6,032,018 licensed producers in America. Florida has most, 392,050; Alaska least at 33,432. 24,709 agents had their licenses suspended, of which, surprisingly, 23,849 were in Delaware. The next leading state was Florida at 496 suspensions. Fourteen states did not suspend any producer licenses. 1,985 producers had their licenses revoked (California had the most at 491; three states did not revoke any licenses. New Mexico (home to 88,982 producers) and Vermont (home to 52,755) took no action of any sort against any agents.
- Consumers filed 322,872 complaints with state insurance regulators in 2009. New York had the most, 57,754; Alaska the least, 332. Consumers also made 2,362,588 inquiries in 2009. Florida had the most, 454,251; South Carolina the least, 50.

### Some Tests of Resource Adequacy

The average state has 223 staff and $31 million to regulate 141 domestic insurers and 1,292 foreign companies. It performs twenty-five financial exams, fourteen market conduct exams and eight combined financial and market conduct exams. It holds one disciplinary hearing and one rate hearing, responds to 6,209 consumer complaints and 45,434 inquiries from consumers. It suspends or revokes certificates of authority from five insurers and issues twenty-seven market conduct orders. It regulates 125,303 producers, disciplining 549 of them. It also runs an antifraud division, writes consumer brochures and creates websites with information for consumers, producers and insurers.

The workload is great and resources in most states are inadequate to do all the work needed. Much of the state work I have reviewed over the years, such as market conduct exams and regulatory efforts on rates, have been superficial and usually deferential to the position of insurers. Market conduct exams almost never discover abuse until well after a private lawsuit uncovers it. These exams are usually a bean-counting exercise rather than a rigorous fact-finding process, like discovery in a lawsuit.

As pointed out above, the average state has only two life actuaries and one property/casualty actuary, whereas insurers often have over a hundred actuaries. The resource allocation is grossly uneven and consumers are the loser.

Nationally, each member of a typical state department's staff is responsible for 6.4 insurance companies on average, including 0.6 domestic insurers. Each staffer, on average, must also monitor 562 producers and handle 28 consumer complaints and 204 inquiries from consumers. He or she must also contribute to financial and market conduct exams, hold hearings, help handle thousands of filings from insurance companies for rate and form changes, take down insolvent companies and run them off, along with other duties. No wonder a New Jersey insurance commissioner once lamented that he was "outgunned" in trying to effectively regulate insurance.

The number of insurers regulated per staff member varies from a high of fifty per staff person in South Dakota to a low of one per company in California and Texas. Looking at the number of complaints per investigator, the national average is 546 complaints per year, ranging from 2,332 complaints per investigator in West Virginia to 96 per investigator in Maine. It is no surprise, therefore, that the usual complaint results only in a forwarding of the complaint to the insurer, with the response passed back to the consumer and no action being taken to rectify any abuse. In claims disputes it is almost unheard of for a state to order an insurer to pay what it owes.

The number of years it would take to complete financial examinations on domestic companies at the rate of completion of 2009 is 9 years,[28] a figure that ignores the five states that completed no exams. If foreign insurers were included in the calculation, it would take 155 years. The number of years it would take to complete market conduct examinations on domestic companies at the 2009 rate of completion is 41 years, ignoring the 14 states that completed no exams. If foreign insurers were included in the calculation, it would take 309 years.

It is obvious that, with only a few exceptions, the states are not equipped to fully protect consumers from abusive practices.

### Challenge #4—Lack of Consumer Power— The Uneven Playing Field (Part 2)

#### The absence of an organized consumer presence in almost every state

In all but three states, there simply is no consumer presence to come before the commissioner. This greatly exacerbates the problem of most regulators viewing themselves as a judge, rather than as an activist. It is impossible to be an arbiter with no organized, funded, effective and professional consumer presence to argue the contrary position to the heavily lobbied industry positions.

Only a few states have attempted to empower consumers. Florida has a consumer advocate, but this office is within the insurance department and not in a position to independently criticize the commissioner. Texas has the Office of Public Insurance Council that is independent of the commissioner, but this person is appointed by the governor, who also appoints the commissioner. That is more independent but not completely so. California has a unique system, where a consumer group can intervene in a proceeding (such as a rate filing request) and receive funding after-the-fact, if the commissioner determines that the group made a "substantial contribution" to the proceeding. This is financially very risky for a group and rarely used, but it does offer outside groups the possibility of greater influence and adequate funding for their efforts.

#### The inadequate NAIC consumer participation program

The NAIC is a complex structure regulating a very complicated insurance system. The NAIC has 13 Committees. The committees have 26 working groups. The working groups have 61 task forces. There are also 17 subgroups. This means that there are 127 groups holding meetings, teleconferences, etc.

After years of refusal to do so, the NAIC did create a consumer participation program that funds the travel costs of designated consumer representatives who come to NAIC meetings. This does represent a step toward real consumer participation, but the NAIC provides no funding for staff or for the time the consumer representatives spend on teleconferences, at meetings and working to develop a serious position on an issue. Coupled with the snail-like pace of NAIC deliberations, the consumer participation program is an inadequate process for providing meaningful consumer input to the NAIC.

At every NAIC meeting, there are hundreds of industry representatives present who are funded by consumers, since the cost of all lobbying by insurers is billed through as a permitted cost in consumer premiums. These many industry representatives are debating only a handful of funded consumer representatives. These 17 people typically work on insurance part-time. They must cover 127 meetings at every NAIC event. The NAIC meets three times a year, which means that the advocates must cover 381 meetings, or more than 17 per person. This is clearly insufficient to provide adequate consumer representation, particularly considering that there are teleconferences between the meetings, extra meetings that are sometimes scheduled, and that advocates must do research and write reports on in order to properly participate. Additionally, insurance interests back home usually lobby individual commissioners very hard on their upcoming votes at NAIC. Several experts, including the author, have quit serving as funded consumer representatives in frustration over the grossly imbalanced situation. Moreover, the NAIC has repeatedly rejected requests to fund a more effective consumer representation program.

While the NAIC has rejected requests for a more meaningful consumer representation program, it does understand the complexity of the insurance industry. In a letter dated February 9, 2011, the NAIC leadership bitterly complained to Treasury Secretary Timothy Geithner over what the NAIC saw as inadequate representation on the Dodd-Frank Financial Stability Oversight Council. The letter says, in part, "State regulation of insurance is a complex system that relies on the collaboration, information sharing, and expertise of regulators from around the country, and is built on a platform of robust financial reporting and analysis supported by the NAIC." Clearly, Director Huff needs to call upon the resources of that complex system, and not merely the employees of the state of Missouri. To illustrate this point, we acknowledge and appreciate that three NAIC employees have been allowed to support Director Huff already, but this level of participation is not remotely sufficient. While the NAIC staff members assigned to support Director Huff have valuable expertise, no three individuals can have the depth of knowledge with all insurance regulatory topics necessary for full, active, and effective participation in the activities of FSOC. In addition to NAIC support, Director Huff may need assistance from insurance regulators in other states, as FSOC has nine separate committees and subcommittees that conceivably are working on issues relevant to insurance.[29]

Apparently, according to NAIC, Missouri's 201 staff and three NAIC staff are not enough to cover the FSOC's nine committees, but 17 consumer representatives who are not paid to do their job at the NAIC are sufficient to cover consumer interests on 127 committees at the NAIC.

#### Individual consumers are generally very intimidated in any insurance transaction, whether buying a policy or dealing with claims

Individual consumers have limited ability to fend for themselves in the insurance marketplace, although attorney involvement with claims does help. Moreover, the success that insurers have had in many states in undermining private litigation, or in rolling back key consumer protection regulations, have decreased the clout and increased the confusion that consumers have.

Consumers face real issues when trying to understand insurance, such as:

***Insurance Is a Complex Legal Document. Policy Lag Time.*** Consumers pay a significant amount for a piece of paper that contains specific promises regarding actions that might be taken far into the future, when a claim arises.

***Determining Service Quality Is Very Difficult.***

***Financial Soundness Is Hard to Assess.***

***Pricing Is Dismayingly Complex.*** Some insurers have many tiers of prices for similar consumers—as many as hundreds of tiers in some cases. Consumers also face an array of classifications that can number in the thousands of slots.

***Underwriting Denial.*** After all that, the consumer may be turned away.

***Mandated Purchase.*** Government or lending institutions often require insurance. Consumers who must buy insurance do not constitute a "free-market."

## Conclusion and Some Ideas for Reform

There are several steps that could be taken to provide more balance between the overwhelming influence of insurance companies and the almost non-existent power that consumers have in the regulatory process, including:

### Reducing Undue Industry Influence

First, as required under Proposition 103 in California, expenses used in rates paid by consumers should be segregated and lobbying and campaign finance expenses should be excluded from rates. It is one thing for insurers to spend to influence legislators, regulators and elections with their own money; it is quite another thing to bill that to consumers. This is forced speech that consumers have no say in and must be stopped.

Second, viable state consumer representatives must be developed and funded, as discussed in "Lack of Consumer Power" below.

Third, campaign finance controls must apply to both elected commissioners and the governors who appoint commissioners. For elected commissioners, this means full, "real time" disclosure of contributions before the election. For appointed commissioners, disclosure of donations to the governor and the individual to be appointed must be provided before the appointment is made.

Insurers must disclose all lobbying expenditures, as well as what the expenditures were for (phone records, agendas and minutes of meetings, letters, emails, etc.) on each major decision made by a commissioner. This information should be made public contemporaneously with those major decisions affecting a particular insurer. This "Contact File" should disclose all notes, letters, and contacts in the process leading up to a regulatory decision.

States should hold more hearings, whether on-line or in person, to hear all sides in a matter. This is particularly important in states with consumer groups in place. The California method of funding intervention, where the filing insurer covers fees if the consumer group makes a "substantial contribution," should be adopted in many more states.

### Lack of Will

Public interest groups and individual consumers should get more involved in the selection of the insurance commissioners, to ensure that "activist" commissioners intent on protecting the public, rather than "arbiter" commissioners, are selected. This is another strong reason why more state consumer groups must be created and funded (see "Lack of Consumer Power" below). Today, the governor or other appointer typically hears only from industry representatives, which is reflected in the selections that are made.

The creation of effective insurance consumer groups will also give commissioners a second opinion on important issues coming before them. Therefore, even if the commissioner is inclined to be only an arbiter, at least he or she will hear both sides when making key decisions.

Transparency in lobbying and the release of records regarding contact with industry representatives at the time a decision is made will help reduce the "smoke-filled-room" nature of the opaque decision-making process that occurs in many states.

The NAIC should address one aspect of the lack of will to protect consumers that many commissioners have, by establishing strong ethics rules that commissioners must meet before becoming a member of the NAIC. These ethics rules should restrict "revolving door" activities, stop the embarrassing wining and dining of commissioners by the industry at NAIC meetings and at home, and require transparency when lobbying occurs on NAIC actions, including lobbying on NAIC upcoming votes that occurs away from the NAIC meetings in commissioners' home states, among other requirements. NAIC leaders have claimed that ethics standards must be imposed by the individual states, not the NAIC. However, the only effective way the NAIC can ensure the integrity of its actions and decisions is to impose these standards itself.

### Lack of Resources

It is clear that both the quantity and quality of state insurance department staff must be significantly increased. Decades ago, a study CFA did with the Professional Insurance Agents (PIA) concluded that state regulators should spend a minimum of ten percent of revenues they collect from taxes, licenses and fees for regulation. 35 states fail this test; ten do not even reach half (five percent) of the standard.

State regulators need to have the resources to retain more well qualified professionals, like actuaries, lawyers, examiners and such, in order to properly fulfill their function and to adequately protect consumers. Consumers cannot be protected when staff is insufficient in either numbers or abilities.

Consider this startling fact: a one-tenth of one percent factor on all insurance premiums would generate $1.7 billion for consumer protection. I think most American consumers would gladly add that tiny element into the rates they are paying if they understood that the money generated would be used to protect them from unjust rate hikes, unfair discrimination and unjust claims practices. Certainly the consumer would benefit from reforms generated by advocacy paid for by that one-tenth of one percent in ways that would dwarf the cost (the estimated savings from such a system back in 1996 was $65 billion).[30]

### Lack of Consumer Power

Only California has a very highly developed consumer group presence. The work of Consumer Watchdog (Santa Monica), Consumers Union (San Francisco), United Policyholders (San Francisco) and others is an example of excellent consumer protection for groups in other states to emulate. The record of interventions, litigation, media work and direct help to consumers is enviable if you live in any other state. New York has highly developed consumer groups as well but they are not focused on insurance in the same way as in California. They have done excellent work when they get involved, but their effort does not match the successes of the California work.

Texas has the only advocate office established by law outside of the insurance commissioner's control. The Office of Public Insurance Advocate has done some wonderful things over the years and deserves a lot of credit for its efforts. The problem with the office is that the governor, who also appoints the insurance commissioner, appoints the advocate. Thus, the office is sort-of independent, but not fully so.

There are national advocates who deal with insurance, including the Insurance Group at Consumer Federation of America and the Center for Economic Justice. These groups have done some good work too, but they are small for the work involved, trying to cover 50 states and Washington, D.C. Sadly, most issues have to go uncovered by these groups.

As mentioned above, the NAIC Consumer Participation Program is better than nothing, but woefully inadequate to cover all the big consumer issues that make it to the NAIC.

States must develop and fund a serious consumer presence if insurer abuses, from unfair and excessive pricing to claims, are to be properly addressed. This may be the single most pressing need to begin to balance the undue insurance industry power that dominates insurance regulation in the United States.

In addition, insurance commissioners must be more proactive in seeking consumer input. Commissioners should be required to have at least a quarterly session with consumers to ask their input on important issues coming up before the Department.

### Motivating State Action

The one thing that motivates states to act, even against industry power, is protection of their turf. Threat of federal action causes a state response. The commissioners acknowledge this.[31]

Given the power that the insurance industry has in most states, it is unlikely that many state legislatures will act on their own to prevent insurer abuse. Only if the people themselves act, as happened in 1988 in California when Proposition 103 was enacted, will significant reform occur in a state.[32]

Federal minimum standards or even the threat of federal takeover of some or all of state regulation would result in more movement by the states. There is not likely to be a movement in that direction in the current political climate, but the pendulum may swing. When this happens, public interest organizations, consumer oriented experts and the public must be ready to push for federal minimum standards of protection and for an end to the antitrust exemption that insurers still enjoy.

### A Bright Spot

One bright spot for insurance consumers has been in claims. The advent of the tort of bad faith has done more to discipline the insurance industry than all of state regulation combined. Unfortunately, bad faith is usually not available in third-party cases. It should be expanded to those cases. Further, class actions have uncovered major scams that individual cases would never find because the abuse may be small but repeated thousands of times.

Insurance companies hate bad faith claims and class actions and are doing all in their power to erode the consumer protection that these lawsuits give consumers. Having succeeded in weakening state insurance regulation to a great degree, insurers have their sights set on lawyers and the courts and on undermining the last vestiges of consumer protection.

## Endnotes

1. National Association of Insurance Commissioners, 2009 Insurance Department Resources Report 40-41 (2010).
2. Number of households in 2009 estimated by increasing the U.S. Census Bureau's 2000 household count of 105 million households by the 9.1 percent increase in population reported by the Census Bureau from 2000 to June 30, 2009.
3. U.S. Dep't of Commerce, Bureau of Economic Analysis, Personal Income and its Disposition (2011), *available at* <http://www.bea.gov/newsreleases/national/pi/2011/pi0211.htm>.
4. U.S. Dep't of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey in 2009 (2011), *available at* <http://www.bls.gov/cex/csxann09.pdf>.
5. *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).
6. 15 U.S.C. §§ 1011-1015.
7. *See generally* Sharon Tennyson, Networks Financial Institute, Indiana State Univ., Efficiency Consequences of Rate Regulation in Insurance Markets (2007), *available at* <http://www.networksfinancialinstitute.org/Lists/Publication%20Library/Attachments/15/2007-PB-03_Tennyson.pdf>.
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11. Walter L. Updegrave et al., *How the Insurance Industry Collects an Extra $65 Billion a Year from You by…Stacking the Deck*, Money Magazine, Aug. 1, 1996, *available at* <http://money.cnn.com/magazines/moneymag/moneymag_archive/1996/08/01/215477/index.htm>.
12. As an example, when consumer groups were making progress in a number of states to end the use of credit scores for insurance purposes, NCOIL proposed a bill that looked like it would control credit-scoring abuses but, in fact, did nothing. This gave legislators the opportunity to look like they were voting for reform while keeping insurers happy and making campaign contributions.
13. The executives are listed on the 2010 Executive Committee page on NCOIL's website, <http://www.ncoil.org/ncoilinfo/committees/executive.html>. The page shows 61 individuals, but one of them was not listed on that state's web page as being a member of the legislature. Information on employment was from individual state legislative web sites and attorney information from Martindale-Hubbell.
14. Press Release, Consumer Fed'n of Am., Most State Legislators Involved with National Insurance Organization Have Close Ties to Insurance Industry (July 9, 2003), *available at* <http://www.consumerfed.org/financial-services/185>.
15. Robert H. Miles & Arvind Bhambri, The Regulatory Executives, (Sage Publications 1983). A detailed look at this important study is found below.
16. *NAIC Under Fire*, Insurance Networking News, Mar. 23, 2011.
17. *Id.*
18. Comptroller General of the U.S., Issues and Needed Improvements in State Regulation of the Insurance Business (1979), *available at* <http://www.gao.gov/products/PAD-79-72>.
19. *NAIC Under Fire*, Insurance Networking News, Mar. 11, 2011.
20. Joseph B. Treaster, *Consumer Groups Criticize Insurance Regulations Chief*, N.Y. Times, Mar. 4, 2004.
21. *Working With State Regulators to Increase Insurance Choices for Consumers*: *Hearing Before the H. Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Fin. Serv. Comm.*, (2004) (statement of the National Association of Insurance Commissioners).
22. National Underwriter, Property/Casualty Ed., *Csiszar Bolts from NAIC to Head PCI*, Aug. 23, 2004.
23. Miles & Bhambri, *supra* note 15.
24. *Id*.
25. *Id*. Miles and Bhambri reported that "Activists tend to be Democrats operating in urban states; arbiters tend to be Republicans operating in nonurban states." *Id.* Not surprisingly, activists were more likely than arbiters to confront the industry. On a score system of one ("accommodative") to the industry to 10 ("adversarial" to the industry), activists ranked themselves as 6.4 vs. arbiters ranking of themselves as 3.9.
26. Nat'l Ass'n of Ins. Comm'rs, 2009 Insurance Department Resources Report (2010).
27. American Academy of Actuaries, *Directory*, <https://actuarialdirectory.org/SearchDirectory/tabid/242/Default.aspx> (last visited Aug. 26, 2011).
28. Most states have laws requiring exams every three to five years so these requirements are not being met.
29. February 9, 2011 letter from NAIC to Honorable Timothy Geithner, Secretary of the Treasury, available at http://www.naic.org/documents/testimony_letter_110209_fsoc_geithner.pdf.
30. Updegrave, *supra* note 11. A $65 billion benefit for a $1.7 billion expenditure is a great benefit/cost ratio for consumers of over 38 to 1. *Id.*
31. "Commissioners generally agree that the threat of federal regulation has stimulated more effective state regulation of insurance and more responsiveness to insurance-related public policy issues on the part of insurance companies." Miles & Bhambri, *supra* note 15.
32. Of course, groups like Ralph Nader's organization, Consumer Watchdog, and other groups organized this effort. Money was raised (although the $2.9 million they raised was small compared to the $63 million industry-funded effort against the proposition) by the California organizations that took the issue to the public.

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# Insurance Consumer Protection Efforts by Government Regulators: Evolving Under Scrutiny

By Amy Bach and Peter Kochenburger

## Introduction

The business of insurance is infused with a public purpose. Insurance is an economic necessity in a market-driven society. It enables everyone from individuals to multi-national corporations to obtain financial protection against the risks inherent in living and conducting business in a complex society, including owning property, engaging in a profession and protecting the financial security of a family. Insurance promotes peace of mind, instilled by a sense of certainty and predictability, and the financial security that enables individuals and the private sector to plan and progress.

Insurance policies are legal contracts that create duties and rights for insurers and policyholders. They are also unilateral contracts of adhesion. The policyholder pays a premium in exchange for the insurer's promise (as expressed in small type in policies that typically exceed dozens of pages) to pay covered claims that may occur months, years or decades in the future, and policyholders have no recourse to purchase new insurance to cover existing claims. They depend, therefore, upon insurers keeping their side of the bargain. For these reasons, access to insurance, the terms of the insurance agreement, and an insurer's financial ability and willingness to pay valid claims are primary areas of both regulatory attention and the source of significant litigation, with thousands of cases affecting the public interest being litigated throughout the United States at any given time.[1] This article focuses on the effectiveness of current and past governmental efforts to protect insurance consumers and the importance of private litigation to enforcing this money for a promise contract.

## Government Regulation of Insurance in the United States

The business of insurance in the United States is primarily policed in four ways:

- State regulation
- Private lawsuits (coverage and bad faith claims, class actions and unfair business practice suits)
- Competition[2]
- Federal regulation

Insurance in the U.S. has several distinguishing features. First, by premium it is the world's single largest market; only the European Union's 28 member states' combined premium share is comparable.[3] Second, despite its size, the U.S. is the only nation with a mature insurance market that is not regulated at the national level. Rather, each state has virtually exclusive control over insurance, checked only by minimal constitutional limitations and public policy, as determined by state legislators and insurance regulators. The federal government's role is minimal, and until 2011 there was no federal agency even charged with monitoring the insurance industry. While the Dodd-Frank Wall Street Reform and Consumer Protection Act created the Federal Insurance Office (FIO), its mandate is quite limited, it has few regulatory responsibilities and powers, and it generally cannot preempt state insurance regulation.[4]

*"Insurance is an economic necessity in a market-driven society. It enables everyone from individuals to multi-national corporations to obtain financial protection against the risks inherent in living and conducting business in a complex society…"*

The reasons for state-based insurance regulation are historical, political and practical. When insurance first became regulated in the U.S. around the mid nineteen hundreds,[5] the federal government's overall regulatory responsibilities were still minimal and insurance was considered an issue of local concern. The Supreme Court protected state regulatory control in *Paul v. Virginia* where it determined that insurance was not interstate commerce and thus could not be regulated by the federal government.[6] The Court reaffirmed *Paul* over the next six decades until 1944 when the Court came to a different conclusion in *United States v. South-Eastern Underwriters Association*, ruling that the insurance business was sufficiently inter-state in character to permit federal regulation.[7]

Congress responded quickly, upon the urging of the National Association of Insurance Commissioners

(NAIC), state regulators, agents and insurers, and in 1945 passed the McCarran-Ferguson Act, which grants insurers limited immunity to federal antitrust laws and more significantly, reconfirmed an explicit preference for state insurance regulation.[8] Though sometimes inaccurately referred to as "preempting" federal law, McCarran-Ferguson essentially establishes a rule of statutory construction that seeks to preserve state regulation over the "business of insurance" unless Congress has clearly indicated its intent to include insurance within the scope of the law at issue.[9] Congress is free to regulate insurance as it can any other financial services product whenever it so desires.

Until the 1990s, state regulators, agents and brokers and insurers were generally in agreement as to the desirability of state-based regulation (though insurers were critical of numerous aspects), but this political consensus has fractured, with many of the major property casualty and life insurers urging greater regulatory uniformity through federal intervention, typically in the form of an "optional federal charter."[10] The states, led by the NAIC, have successfully fended off any significant movement to federal regulation and the NAIC's quasi-regulatory role has been significantly expanded by both Dodd-Frank and the Patient Protection and Affordable Care Act.[11] However, the FIO is required to conduct a major study on how to "modernize" insurance regulation, which likely will lay the terrain for the next battle between proponents of state and federal regulation.[12]

## State Insurance Regulation

Factors that impact the varying extent to which states regulate insurers include:

- Politics (regardless whether the regulator is appointed or elected).
- The extent of the regulator's statutory authority.
- The remedies and damages available to policyholders through private litigation (e.g., the definition of bad faith and ability to recoup attorney's fees).
- The existence or absence of administrative regulations and bulletins related to insurance sales and claims practices.
- The ability and willingness of other state agencies to protect insurance consumers, such as the state attorney general.
- Economic and marketplace conditions in the state.
- The number of competitors in each product line of insurance being sold in the state.
- The existence or absence of organized and effective consumer groups.
- Media coverage.[13]

State insurance regulators are charged with the dual roles of policing insurers solvency/claims-paying capacity, and protecting consumers. Historically there have been significant achievements and failures in these areas. Each state superintendent or commissioner has his or her own view on which role is more important and where they will devote their agency's limited resources and staff capacity. As political appointees, their agendas are also constrained by their governor and as the CEO of a complex, entrenched bureaucracy—e.g., the department of insurance—by those who report to them. With a few notable exceptions, solvency regulation, which historically has been the major focus of state insurance departments and absorbed most of their resources, has been successful.[14] While insurer insolvencies (inability to pay claims) are not rare, they have usually had a limited, local impact on the insurance marketplace. In addition to closely regulating accounting standards, reserving practices and allocation of assets to non-insurer affiliates, state insurance departments have the ability to place insurers into receivership and, if necessary, to order their liquidation.[15] Each state also has an insurance guaranty fund to pay otherwise uncovered claims, though there are significant exemptions and limitations for these claims.[16]

## The Critical Importance of Regulating Insurance Sales and Claim Practice

The tools available to state insurance regulators vary by state, but usually include authority to:

- Issue data calls to insurers requiring them to provide specific information related to financial matters, sales, underwriting, marketing and claims.[17]
- Conduct Market Conduct exams, which are akin to an audit.[18]
- Review insurers' annual financial statements and other reporting requirements.
- Take actions to maintain an orderly marketplace and avoid disruptions due to mass non-renewals, boycotts, etc.[19]
- Provide regulatory guidance through bulletins, advisory notices and other official statements that express their department's policies on a specific matter or interpretation of state laws or regulations.[20]
- Mediate consumer complaints and order compensation or redress.[21]
- Proposing (or opposing) legislation.[22]
- Bringing enforcement actions against an insurer for violating insurance laws and regulations.[23]
- Approval over insurance rates.[24]
- Challenge unfair sales, rating, underwriting and claim practices.[25]
- Use what regulators often refer to as the "bully pulpit" and the media to influence insurer's conduct.[26]
- Leverage regulatory authority and work cooperatively with insurers to reach voluntary agreements and informal settlements.[27]

Several developments have spurred the consumer protection function of state insurance regulatory agencies in recent years: Increased media attention in the aftermath of Hurricane Katrina, AIG, and health care reform have "upped the ante" on regulators to be more pro-active in protecting consumers. Skyrocketing property insurance rates in coastal states have fueled the growth of grass roots insurance consumer advocacy organizations that in turn have put increased pressure on regulators. A third factor that has enhanced consumer protection efforts by state insurance regulators is the growth of the Internet. Not only are more consumers contacting regulators via email, but regulators are offering more tools, information and resources to consumers via their state department websites. And while insurance department websites have been subject to legitimate criticism for being too technical and "off putting" to consumers,[28] many state sites have substantially improved.

A fourth and very significant factor that has enhanced state consumer protection efforts in recent years is improved coordination with other states at the NAIC, fueled in part by the desire to avoid the threat of federal regulatory preemption. The NAIC is a unique association that has a professional staff and a research arm. It organizes meetings and conferences throughout the year for state regulators and staff from all 56 states and territories, it engages in fact-finding, public policy debates, publishes reports, holds hearings, and promulgates model acts for states to adopt. It also runs a consumer participation program that allows policyholder advocates to participate in its proceedings and offer direct input to state regulators. Many NAIC model acts have proven beneficial to consumers. For example, the NAIC's model Unfair Claim Settlement Practices Act has set very useful minimum standards in a majority of states. While consumer advocates consider few NAIC model acts ideal, they generally help smaller states with fewer resources implement basic protections and establish a floor or baseline for claim handling standards.

## The Interplay Between Private Lawsuits and Consumer Protection Efforts by Regulators

Many of the most successful consumer protection efforts by state regulators have been undertaken after an unfair insurance practice has been exposed in the media or in a private lawsuit. Three examples:

1. After discovery in private lawsuits revealed a pattern and practice by the UnumProvident/Paul Revere group of companies of cheating consumers on disability claims, state regulators undertook a multi-state Market Conduct Examination and took various individual and coordinated actions that resulted in settlement agreements and modified claim practices.[29]
2. After a series of articles appeared in Bloomberg News in the summer of 2010, state regulators through the NAIC convened a series of hearings on Retained Asset Accounts, conducted a survey and adopted a sample bulletin.[30]
3. Discovery in a number of class action suits revealed that certain life insurers were not using due diligence to find beneficiaries. In 2011 regulators responded by convening hearings, issuing press releases and orders.[31]

## Practical Constraints on Governmental Regulation of Insurance Companies

Despite the regulatory tools available to them, state regulators have significant practical limitations on their ability to police the insurance marketplace, including budgetary, staffing and political considerations, and the formidable resources of the entities they regulate. Staffing and salary caps, civil service rules and other factors challenge regulators who want their agency to be pro-active in protecting consumers.

Some state insurance regulatory agencies have only a handful of lawyers and actuaries on staff and state budget crises may make it difficult or impossible to even maintain existing authorized staffing levels.[32] In contrast, major insurers often have hundreds of lawyers, compliance personnel and actuaries on staff, as well as the financial resources to hire some of the best law and accounting firms in the country when the issues are sufficiently important to them.[33] Given the limited regulatory resources, the lack of federal authority over insurance, and the fact that businesses and people rely on insurance benefits in time of need,[34] private litigation is a necessary complement to governmental insurance regulation.

## Private Enforcement Remedies Are Essential for Protecting Consumers

New York has enacted several NAIC model laws designed to protect consumers, including the Unfair Claim Settlement Practices Act, which establishes a minimum standard of conduct for insurers in handling claims.[35] Depending upon the precise provision at issue, this Act can protect both policyholders and claimants (e.g. plaintiffs) from specified unfair practices. However, as in most states, there is no private right of action under this statute and enforcement is left to the Department of Insurance. This is unfortunate, not due to a lack of regulatory zeal, but because of the very limited resources within any state insurance department to adequately police the insurance industry in this area. While New York's department is able to devote significant resources to protecting insurance consumers (see note 24), it cannot hope to fully police the insurance marketplace, with the millions of insurance activities that take place each year theoretically under its regulatory jurisdiction. Marketing, underwriting, and selling insurance, working with insurance producers, and adjusting claims, all involve various types of regulation and are largely invisible to any regulator, unless a party complains or the activity is reviewed through relatively rare market conduct exams.

Therefore the private bar and consumer advocacy are essential components to an insurance regulatory regime. The efficacy of enforcing consumer rights through litigation depends in large part on the adequacy of remedies available. Here, New York has significant problems. While New York recognizes the concept of insurer bad faith, its definition is notoriously constricted and offers far less protection to insurance consumers than this doctrine does in most other states. New York law requires that a policyholder demonstrate its insurer had a "gross disregard" of its insured's interests and "engaged in a pattern of behavior evincing a conscious or knowing indifference.…"[36] Further, New York law only allows the policyholder to recoup attorneys' fees in a successful coverage action against her insurer if the policyholder was "cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations," typically meaning that the insurance company initiated the coverage litigation disputing its duty to defend under a liability policy.[37]

New York's common law is among the most pro-insurer in the country, though there have been recent changes that better acknowledges the rights of policyholders.[38] However, New York law still remains unfavorable in important areas related to private enforcement actions by insurance consumers. This creates a regulatory gap that cannot be compensated for by government regulatory actions.

## Conclusion

Competition alone has never been and never will be a sufficient force to maintain a healthy balance between insurance companies' financial interests and the interests of their policyholders. The combined efforts of government regulators, private attorneys and consumer advocates are imperative in this context. Insurance products are an economic and often legal necessity in the modern world, but insurers and policyholders are in an unequal bargaining position both at the point of sale and in the claim process after a loss.

Insurance policies are contracts of adhesion that are written and largely interpreted by insurers. When a person or business buys an insurance policy, they generally have little say or understanding as to the quality of the product. With the exception of large, sophisticated businesses, consumers entering into an insurance contract have little bargaining power on anything but price. While price competition among insurers exists, it does not protect consumers with regard to the important terms of an insurance contract.

This disparity of knowledge and power is even greater when a claim arises. The money for a promise nature of the insurance contract means the insurer's obligations to perform will only occur after, and sometimes long after, the consumer has paid the policy premiums. Claimants generally are in a vulnerable position both because when presenting a claim they have little leverage with the insurer and because they have suffered a financial, and often an emotional loss. The insurer has the money and perhaps more important, usually is the party who interprets the contract and determines its own payment obligations. The "law of the insurance adjuster" typically prevails, unless a policyholder seeks legal counsel or regulatory assistance.[39]

Competition among insurers can't protect consumers against this imbalance. Further, there is a natural conflict between the financial interests of an insurer and a policyholder when a claim arises; the less an insurer pays on a claim, the higher its profits will be, but the worse off the loss victim will be, and vice versa. While clearly the competitive threat of getting a bad reputation does motivate insurers to pay claims fairly and on time, it does not and cannot protect a policyholder in an individual claim scenario.

People and businesses rely on insurers to be a strong, solvent financial safety net that will provide the money they need to recover from a serious loss. Most insurers today are complex entities with complex financial structures and investments. For these reasons, and as noted above, *because* insurers compete on pricing, competition alone cannot ensure that they will provide the essential safety net function. Regulating solvency therefore remains a central function of state insurance departments, and one that has become much more complex as insurers increasingly conduct business on an international scale. However, solvency regulation by itself is insufficient to ensure a fair insurance marketplace, which also requires enforcement of laws regulating the marketing, sales, underwriting and claims handling practices of insurers and their agents.

For all those reasons, competition among insurers has never been and never will be sufficient to regulate the industry. And, because insurers' financial resources are vastly superior to regulators' resources, effective regulation "takes a village." Private lawsuits, combined with legislative oversight, and the vigilance and work of policyholder advocates, are essential complements to the efforts of government regulators.

## Endnotes

1. Insurance law is essentially state law so most insurance disputes are litigated in state courts, often with significant variation in how different courts interpret similar or identical policy language.
2. Though some insurance markets have robust price competition, notably personal auto markets in many states, competition is

reduced by the fact that many insurance products are mandatory, contracts are adhesive and consumers have few tools to shop and compare specific features. Other than price, there is little competition or ability to compare the actual terms of an insurance policy before purchase, even though important coverages and terms might significantly vary by insurer. *See* Daniel Schwarcz, *Reevaluating Standardized Insurance Policies,* 78 U. Chi. L. Rev. (forthcoming Dec. 2011).

3. The U.S. accounted for approximately 35% of the world's insurance premium volume in 2009. Separating out the states, New York would be the eighth largest insurance market, with 2.9% of the world's premiums. Only California exceeded New York, with 4.7%. *Top 50 International Markets*, NAIC'S Center for Insurance Policy and Research, <http://www.naic.org/cipr_stats_page.htm>.

4. 31 U.S.C. § 313 (The Federal Insurance Office is charged with "monitoring" the insurance industry and serving as the U.S. representative at the international level. The Office also has limited authority to preempt state laws that are inconsistent with an international treaty related to prudential (solvency) regulation).

5. <http://www.ins.state.ny.us/hp97wel.htm> (The New York Insurance Department was established in 1860); <http://ifawebnews.com/2011/04/01/new-york-banking-insurance-department-merger-awaits-cuomos-signature/ > (explaining that the Department will merge with the New York State Banking Department in fall 2011 to create the New York State Department of Financial Services).

6. *Paul v. Virginia*, 75 U.S. 168, 183 (1869).

7. *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 550 (1944).

8. 15 U.S.C. § 1012(b) ("No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." The industry remains subject to state antitrust laws, many of which mimic their federal counterparts).

9. 28 U.S.C. § 1610 (Congress can remove all doubt as to its intent in specific legislation to regulate insurance simply by so indicating).

10. *See* Eli Lehrer, Competitive Enter. Inst., Optional Federal Charter for Insurers: *FAQ*, No. 122 (2007), *available at* <http://cei.org/pdf/6170.pdf> (An Optional Federal Charter (OFC) would create a dual regulatory system for insurance similar to what exists for our depository institutions, where the regulated entity determines whether to obtain a state or federal charter (license). As drafted, OFC legislation would have allowed insurers to avoid central features of state insurance regulation protecting consumers, such as rate and form regulation, with no equivalent protection at the federal level. While OFC proponents focus on the advantages of consistency available through a federal insurance license, it is also an ill-disguised effort to deregulate insurance, as other financial services providers were so successful in promoting in the 1980s and 1990s, and which helped lead to the disastrous consequences of 2008 and beyond.)

11. Public Law 111-148 (2010).

12. 31 U.S.C. § 313(p).

13. *See* Michael Pollick, *Herald-Tribune Wins Pulitzer Prize*, Herald-Tribune, Apr. 18, 2011, *available at* <http://www.heraldtribune.com/article/20110418/BREAKING/110419506> (Even one diligent journalist can have an impact on the extent to which a state insurance regulator protects the consumers in his/her state).

14. Insurance Information Institute, *Insolvencies/Guaranty Funds*, <http://www.iii.org/issues_updates/insolvencies/guaranty-funds.html>. (The largest insurance insolvency in the U.S. occurred in 2001, when Reliance Insurance Company, a major commercial property casualty insurer, was put into liquidation by the Pennsylvania Insurance Department. To date, the total cost of the Reliance insolvency is a bit over $1 billion. The net cost of the ten largest insolvencies is approximately $5 billion); *See* Kathleen C. Engel & Patricia A. McCoy, The Subprime Virus: Reckless Credit, Regulatory Failure, and Next Steps (2011) (In contrast, the AIG bailout cost U.S. taxpayers over $160 billion. While AIG was the largest commercial insurer in the world prior to 2008, it was not its traditional insurance operations that failed but its Financial Products Group [based in the UK, but headquartered in Connecticut and theoretically regulated by the U.S. Office of Thrift Supervision], which was largely responsible for AIG's disastrous credit default swaps operations. Our state-based insurance solvency regime required the AIG insurers to maintain sufficient reserves to pay estimated claims and strictly regulated any capital transfers between the insurance entities and other AIG affiliates).

15. N.Y. Insurance Law §§ 7401-7436 (In New York these responsibilities are assumed by the New York Liquidation Bureau, which reports to the Superintendent of Insurance in his capacity as Receiver); *See* <http://www.nylb.org/index.htm> (The Liquidation Bureau also administers the New York Security Fund, which pays claims for insolvent insurers).

16. The New York State Security Fund limits liability claims to $1 million, the highest among the states. Peter Bickford, The Insurance Receivership Process in New York 8 (2008-09), http://www.pbnylaw.com/articles/Insurance_Receivership_Process_NY.pdf.

17. <http://www.ins.state.ny.us/datacall/calls/avail10.htm> (A data call to insurers on homeowners insurance in coastal areas); <http://www.insurance.ca.gov/0250-insurers/0300-insurers/0100-applications/rsb-forms/data-call-initial.cfm> (Or a data call to every title insurance company in the State of California).

18. <http://www.ins.state.ny.us/ex_index.htm> (The New York Insurance Department's Market Conduct exams are available online and provide a useful summary of an insurer's operations).

19. <http://www.ins.state.ny.us/circltr/2007/cl07_11.htm> (showing a circular letter issued by the New York State Insurance Department to notify insurers they were violating state law by non-renewing homeowners' policies where the consumer was not also insuring their car or other property).

20. *See* Press Release, Fla. Office of Ins. Regulation, Video/Transcript of Life Insurance Settlement Claims Practices Hearings Now Available (June 3, 2011), *available at* <http://www.floir.com/PressReleases/viewmediarelease.aspx?ID=3894> (After learning of the evidence that surfaced in private class action lawsuits of life insurers failing to notify beneficiaries of monies owing, the Florida Office of Insurance Regulation and the California Department of Insurance held hearings and took various actions); *see* Press Release, N.Y. State Ins. Dep't, New York Life Insurers Directed to Identify Deceased Policyholders and Pay Unpaid Death Benefits (July 5, 2011), *available at* <http://www.ins.state.ny.us/press/2011/p1107051.htm>.

21. *See* N.Y. State Ins. Dep't, 152nd Annual Report of Superintendent: Calendar Year 2010 (2011), *available at* <http://www.ins.state.ny.us/acrobat/annrpt_2010.pdf> (The New York Department of Insurance reported a significant amount of activity resolving consumer complaints in 2010, including handling over 50,000 complaints and assisting consumers in recovering over $48 Million in insurance benefits. The Department's Consumer Services Bureau has approximately 100 employees).

22. *See* Press Release, Cal. Dep't of Ins., Insurance Commissioner Jones Applauds Passage of Health Insurance Rate Bill Out of Senate Health Committee (July 6, 2011), *available at* <http://www.insurance.ca.gov/0400-news/0100-press-releases/2011/statement093-11.cfm>.

23. *See* Press Release, Cal. Dep't of Ins., Department of Insurance Announces Enforcement Action Against Blue Shield For Denying Autism Treatment (July 13, 2001), *available at* <http://www.insurance.ca.gov/0400-news/0100-press-releases/2011/release096-11.cfm>.

24. *See* N.Y. State Ins. Dep't, *General Guidelines for Rate, Form, Territory, Classification and Rule Filings Submitted*, <http://www.ins.state.ny.us/serff1.htm> (The New York Department of Insurance recently published guidelines for health insurance rate filings); Press Release, Fla. Office of Ins. Regulation, State Farm Insurance Rate Hearing (Feb. 14, 2001), *available at* <http://www.floir.com/PressReleases/viewmediarelease.aspx?ID=3800> (The Florida Office of Insurance Regulation has had to actively police homeowners insurance rate filings in recent years due to steep increases and resulting pressure from policyholders); *see* Consumer Watchdog, Proposition 103's Impact on Auto Insurance Premiums in California: 15 Years of Insurance Reform 1989-2004 (2007), *available at* <http://www.consumerwatchdog.org/resources/15years_Prop103.pdf> (The California Department of Insurance has the most developed property and auto insurance rate review regime in the country due to a 1988 voter-approved initiative that established a rigorous prior approval system).

25. *See* Press Release, N.Y. State Dep't of Ins., Allstate Agrees to $10 Million Regulatory Settlement Over Bodily Injury Claims Handling Processes (Oct. 18, 2010), *available at* <http://www.ins.state.ny.us/press/2010/p1010181.htm> (As state attorneys general have done for years, state insurance commissioners are conducting cooperative enforcement actions with other state insurance departments).

26. *See* Press Release, Ala. Dep't of Ins., ALDOI Directs Insurers to Offer Grace Period (May 2, 2011), *available at* <http://www.aldoi.gov/currentnewsitem.aspx?ID=772> (After a series of 2011 tornadoes devastated numerous communities in his state, Alabama Insurance Commissioner Jim Ridling issued a bulletin "instructing" all insurance companies to provide a 30-day grace period to consumers who were temporarily unable to pay premiums for coverage. Insurers did not legally challenge his authority for this relatively low-impact directive. However, insurers and trade associations routinely challenge regulators' actions, most often via lawsuits seeking to block enforcement of regulations and/or claims that the regulator exceeded their legal authority in some way.); *Sullivan Fin. Group, Inc. v. Wrynn*, 30 Misc. 3d 366, 910 N.Y.S.2d 889 (Sup. Ct., Alb. Co. 2010) (For example, in 2010 several New York trade associations representing agents and brokers sued the Department of Insurance over new compensation disclosure regulations. The trial court ruled in the Department's favor in late 2010 and the associations have appealed).

27. *See* Press Release, Cal. Dep't of Ins., Commissioner Poizner Convenes First of Its Kind Summit to Aid Wildfire Survivors (Dec. 18, 2007), *available at* <http://www.insurance.ca.gov/0400-news/0100-press-releases/0060-2007/release128-07.cfm> ("[V]oluntary claims handling reforms" negotiated by the California Insurance Commissioner with a group of leading insurers after a 2007 wildfire in Southern California).

28. *See* Press Release, Consumer Fed'n of Am, Study Finds Significant Differences in Auto and Home Insurance Information Provided by States to Consumers (Nov. 10, 2008), *available at* <http://www.consumerfed.org/elements/www.consumerfed.org/file/state_website_release_11-10-08.pdf>.

29. U.S. Dep't of Labor, FAQs About the UnumProvident Settlement, <http://www.dol.gov/ebsa/faqs/faq_unumprovident.html> (A series of private lawsuits in California and elsewhere throughout the U.S. spurred regulators in numerous states to initiate their own investigations of disability claim practices by the UnumProvident group of companies. The investigations resulted in a multistate settlement plus settlements by individual states).

30. Nat'l Ass'n of Ins. Comm'rs, Retained Asset Accounts and Life Insurance: What Consumers Need to Know About Life Insurance Benefit Payment Options, <http://www.naic.org/documents/consumer_alert_raa.htm> (Private lawsuits are challenging numerous features and practices related to Retained Asset Accounts (RAA). There are life insurance policies with a feature that sets up a checkbook account instead of paying lump sum benefits upon the death of the policyholder. In response to the allegations in these suits, as reported in Bloomberg News, the NAIC convened hearings and issued a sample bulletin that sets forth minimal disclosure standards for RAAs).

31. *See* Press Release, Cal. Dep't of Ins., *supra* note 22.

32. This is both unfortunate and often unnecessary. Many state insurance departments are funded through industry assessments (as are many federal regulatory agencies) rather than state general funds, and cutting department staff or refusing to fill open positions has no impact on the state budget, though perhaps it serves the political purpose of allowing elected officials to claim reductions in the state workforce. Insurers have been traditionally supportive of adequate funding for insurance departments, as solvency regulation is both complex and necessary to maintain an effective insurance market; *see* <http://www.naic.org> (The *Insurance Department Resources Report,* available for purchase through the NAIC website).

33. <http://www.opensecrets.org/industries/indus.php?ind=F09#lobtotals> (Insurers also combat governmental regulation through a national corps of trade associations and lobbyists that blanket state capitols and Washington D.C. Aiming for Washington alone, insurers contributed $47.5 million to Congressional candidates in 2007 and 2008. Insurers likely spend significantly more lobbying in the states, given our state-based regulatory structure); <http://influenceexplorer.com/organization/state-farm-insurance/db434c50b42d49588c874518e8e1e04b> (One leading national insurer spent two-thirds of its lobbying dollars in the states between 1989–2010, compared to one-third in federal elections).

34. It is worth emphasizing that policyholders usually become aware of coverage gaps only when a claim is denied. It is then too late to shop for additional insurance to cover the loss. This fact differentiates insurance from other consumer products and highlights the importance of regulating insurer claims handling.

35. N.Y. Ins. Law § 2601 (This section prohibits, for example, "knowingly misrepresenting to claimants pertinent facts or policy provisions related to coverages at issue," and "not attempting in good faith to effectuate prompt, fair and equitable settlements of claims submitted in which liability has become reasonably clear.")

36. *Pavia v. State Farm Mut. Auto. Ins. Co.*, 82 N.Y.2d 445, 454, 605 N.Y.S.2d 208, 212 (1993).

37. *Mighty Midgets, Inc. v. Centennial Ins. Co.*, 47 N.Y.2d 12, 21, 416 N.Y.S.2d 559, 564 (1979); *U.S. Underwriters Ins. Co. v. City Club Hotel, LLC,* 3 N.Y.3d 592, 789 N.Y.S.2d 470 (2004).

38. N.Y. Ins. Law § 3420 (a)(5) (In 2008, New York passed legislation finally acknowledging that an insurer generally cannot deny a claim due to late notice unless it can demonstrate prejudice. Until then, New York was one of only several states that strictly enforced the notice condition as a prerequisite to coverage, regardless of whether the insurer was actually handicapped by the late notice); *See Bi-Economy Market Inc. v. Harleysville Ins. Co.*, 10 N.Y.3d 187, 856 N.Y.S.2d 505 (2008) (In 2008, the New York Court of Appeals expanded the range of damages available against an insurer for improperly denying a claim, though the exact parameters of this decision are not yet well defined).

39. *See* Tom Baker, *Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages,* 72 Tex. L. Rev. 1395 (1994).

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# New York's New Department of Financial Services: Managing Potential Conflicts Within the New Unified Regulatory Regime

By Mark Peters and Mohana Terry

## I. Introduction

On March 31, 2011, New York Governor Andrew Cuomo signed the 2011-2012 State Budget into law, which included landmark legislation that significantly transforms the State's financial regulatory system. This new legislation, entitled the Financial Services Law (FSL), merges the New York Insurance and Banking Departments into a single entity to be known as the Department of Financial Services (DFS), with new and heightened responsibilities over both the insurance and banking industries. Supporters of the FSL have lauded it as vital to ensuring the effective regulation of increasingly complex corporate structures that combine banking, insurance and securities, and to securing New York's continued prominence as a world financial center, whereas opponents of the merger may express concern that the new law will create an unwieldy regulatory regime, with an inherent conflict of interest between the DFS acting as an industry regulator ensuring company solvency, while simultaneously acting as an enforcer of laws designed to protect consumers and investors. This article describes the new regulatory regime created by the FSL, particularly as it applies to insurance companies and the insurance industry, discusses the perceived conflict of interest of having regulators and enforcers living under the same roof, and explains why the perceived conflict is likely illusory.

## II. Overview of the New Regulatory Regime Created by the FSL

### A. The Purpose of the FSL and DFS

The FSL will consolidate the existing New York Insurance and Banking Departments, as well as the enforcement powers provided under the existing insurance, banking and financial services law, into and under the DFS.[1] The articulated goals of the DFS include both preservation of company solvency, as well as consumer and investor protection functions. Specifically, the goals include the following:

(1) promoting the growth of banking, insurance and other financial services institutions within the State of New York;

(2) establishing a modern regulatory and consumer protection regime;

(3) enforcing the banking and insurance laws;

(4) promoting and providing for effective state regulation of the insurance industry;

(5) regulating new financial services products;

(6) promoting the prudent and affordable availability of credit, insurance and financial products and services;

(7) ensuring the safety and soundness of the banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services;

(8) protecting the public interest, including the interests policyholders, and underwriters among others;

(9) promoting the reduction and elimination of fraud, and similar conduct with respect to banking, insurance and other financial services institutions and their customers; and

(10) educating and protecting users of banking, insurance, and financial services products.[2]

The FSL sets forth a detailed framework to facilitate the achievement of these goals, including consolidating the functions of the existing Insurance and Banking Superintendents into a single office, expanding the oversight responsibilities of the new single regulator, and creating a new bureau to investigate and enforce laws with respect to fraud in the insurance and banking industries.

### B. Establishment of the DFS Superintendent

One way in which the FSL will facilitate achievement of the regulatory and enforcement goals listed above is by creating a new office of the Superintendent of the DFS (DFS Superintendent) to assume the responsibilities of the existing Insurance and Banking Superintendents, as well as new and heightened oversight responsibilities with respect to financial products and services.[3] The FSL contemplates that the DFS Superintendent will be selected by the Governor. On May 24, 2011, Governor Andrew Cuomo announced that the State Senate had confirmed Benjamin M.

Lawsky, currently serving as Governor Cuomo's Chief of Staff, to assume the role of the new DFS Superintendent.[4]

The new DFS Superintendent will have broad rights, powers and duties in connection with achieving these goals "expressed or reasonably implied by this chapter [of the FSL] or any other applicable law" of New York,[5] and will have the ability to issue regulations to:

> (1) effectuat[e] any power given to the DFS Superintendent under the provisions of the FSL, the insurance law, the banking law, or any other law to prescribe forms or make regulations;
>
> (2) interpret[…]the provisions of the FSL, the insurance law, the banking law, or any other applicable law; and
>
> (3) govern[…]the procedures to be followed in the practice of the DFS.[6]

Additionally, the FSL expressly authorizes the DFS Superintendent to do the following:

(1) Investigate and research matters impacting consumers…, including monitoring consumer complaints;

(2) protect consumers of financial products and services in a number of ways, including, educat[ing] [them with respect to such products and services, receiving complaints, mediating such complaints or referring them to the appropriate agency for action];

(3) make recommendations to the Governor of the State of New York with respect to issues affecting consumers of and investors in financial products and services;

(4) cooperate and assist with the enforcement responsibilities of the New York Attorney General's Office;

(5) initiate and encourage consumer financial education programs;

(6) assist local governments and non-profits to develop consumer protection measures; and

(7) expand detection, investigation and prevention efforts with respect to insurance fraud (as more thoroughly described below).[7]

The FSL contemplates that the DFS will consist of two divisions, the insurance and banking divisions, each of which will be respectively overseen by a first deputy for insurance and a first deputy for banking as selected by the DFS Superintendent.[8]

### C. Expanded Authority to Regulate Financial Products and Services

The FSL grants the DFS and the DFS Superintendent broad authority to regulate financial products and services, which are defined to include any financial product or service provided by any person regulated or required to be regulated under the banking or insurance law, or any financial product or service offered to consumers. This last point expands the new agency's scope beyond that of either of the two original agencies. However, the following financial products and services are expressly carved out of this definition:

> (1) [products or services] regulated under the exclusive jurisdiction of a federal agency or authority;
>
> (2) [products or services] regulated for the purpose of consumer or investor protection by any other state agency, department or public authority, or
>
> (3) where rules or regulations promulgated by the superintendent on such products or services would be preempted by federal law.[9]

The definition also expressly excludes certain products and services when offered by a provider of consumer goods or services.[10]

The original version of the legislation defined "financial product or service" more expansively to also cover products and services regulated under any other law. Furthermore, it included in the definition any contract involving the types of products or services otherwise specified in the definition. Despite the narrower definition of "financial product or service" in the adopted FSL, the definition still affords the DFS expanded authority, particularly when read in connection with the provisions granting the DRS Superintendent the authority to investigate certain types of fraud and misconduct.

Notwithstanding the broad definition of "financial product or service," the FSL expressly grants the DFS Superintendent discretion to exclude certain products and services from the scope of the DFS regulation:

> The superintendent may promulgate a list of financial products and services excluded from regulation by the superintendent, provided that such exclusion shall not limit in any way the ability of the superintendent to take any actions with respect to fraud provided for in this chapter [FSL], the insurance law, the banking law or any other applicable law.[11]

Note, however, that the DFS Superintendent may adopt any exclusions which will limit his ability to prosecute financial fraud as described below.

### D. Creation of the Financial Frauds and Consumer Protection Unit

The FSL recognizes that fraud can occur across industries, and is detrimental to the social and economic wellbeing of New York's citizens. As such, it calls for the consolidation of the insurance frauds bureau and the criminal investigations bureau, which currently investigate fraud in the insurance and banking industries, respectively, into a new bureau, to be known as the Financial Frauds and Consumer Protection Unit (FFCPU). The new bureau will fall under the supervision of the DFS Superintendent. Prior versions of the legislation also contemplated merging the consumer financial protection activities of the Consumer Protection Board into the FFCPU; however, this was not included in the final, adopted version. Instead, the Consumer Protection Board will be replaced by a new Consumer Protection Division in the New York Department of State; it will not be part of the new DFS or FFCPU.[12]

Once formed, the FFCPU will be charged with investigating and prosecuting fraud involving financial products and services as defined above. Prior versions of the legislation expressly created a new, defined offense of "financial fraud." The original version defined "financial fraud" expansively to cover "any fraud, intentional misrepresentation or deceptive act or practice involving a financial product or service or involving any person offering to provide or providing financial products or services" and included certain specified conduct, significantly, any violation of the Martin Act, an act which does not require proof of a violator's intent to defraud. The second draft of the legislation narrowed the definition of "financial fraud" considerably by removing the references to the Martin Act, and "deceptive acts or practices" from activities that constitute financial fraud, thereby raising the standard for proving a violation. The adopted FSL has removed the defined offense of "financial fraud" altogether, and, instead, gives the FFCPU and the DFS Superintendent general authority to investigate violations of the insurance and banking laws, as well and violations of new law created by the FSL.[13] In instances where the FFCPU has reason to believe that a person or entity has engaged, or is engaging, in prohibited conduct, the DFS Superintendent will have authority to investigate[14] such activities, and impose penalties.[15] The DFS Superintendent will be authorized to levy a civil penalty of up to $5,000 for each intentional fraud or misrepresentation, or up to $1,000 for each violation of the FSL, and applicable regulations issued thereunder. However, unlike previous versions of the legislation, the adopted FSL makes it clear that these penalties will not apply to persons regulated under the insurance law; such persons will be subject to penalties provided under the insurance law.[16]

### E. Assessments on Companies to Fund DFS Operating Expenses

The FSL provides that the DFS will be funded through assessments on regulated companies. With respect to insurance companies, the current insurance law grants the insurance superintendent broad discretion to levy assessments on insurance companies to cover the operating costs of the insurance department.[17] The assessment is calculated in proportion to the gross direct premiums and other considerations, written or received by each insurer in New York.[18] Under the adopted FSL, effective April 1, 2012, the existing assessment law will be repealed and replaced with a provision which generally continues to provide a pro rata assessment. However, in response to industry concerns that insurance company assessments will be siphoned off to cover expenses that are not primarily insurance related, the adopted FSL expressly limits assessments on insurance companies to only cover "operating expenses of the department solely attributable to regulating persons under the insurance law."[19] Prior versions of the legislation did not contain this limitation.

## III. Critics of the FSL May Claim That There Is an Inherent Conflict of Interest with Having Regulators and Enforcers Under the Same Roof

As described above, the new regime not only merges the responsibilities of the existing Insurance and Banking Departments, it also creates new and heightened oversight responsibilities for the single regulator. Under the new regulator regime, the DFS and the DFS Superintendent will be functioning as both the regulatory of insurance, banking and certain other financial services companies and providers, as well as the enforcer of certain consumer and investor protection laws as they apply to such companies and providers; for example, the DFS and DFS Superintendent will be charged with investigating and prosecuting fraud involving financial products. In parallel circumstances, government observers have expressed concerns that the roles of regulator and enforcer are two, separate and distinct functions, often at odds with each other, and that by wearing both hats, the new DFS and DFS Superintendent will serve neither function well.

First, as regulator, critics may believe that the DFS and DFS Superintendent will be primarily concerned with maintaining company solvency, and fostering the growth and development of business in the State of New York. Wearing this hat, the regulator is primarily pro-industry, and pro-company. It may be unsympathetic to consumer complaints, as such complaints may undermine the goals of protecting solvency and promoting industry growth. The very fact that funding of the DFS will come from assessments paid by these regulated companies may also skew the DFS' bias towards industry and away from consumers.

Second, the FSL grants the DFS and DFS Superintendent broad authority over a variety of financial services and products, and expressly creates the FFCPU to investigate and prosecute fraud in the insurance and banking industries. Here, the DFS and DFS Superintendent would be acting as an enforcer pursuant to this authority. Critics of the FSL may believe that this authority effectively usurps enforcement powers from independent actors, such as the New York Attorney General's Office, who are better positioned to investigate and police the conduct of industry participants. An entity functioning as both regulator and enforcer may not actively pursue violators with the same vigor as independent prosecutors.

Finally, the expanded regulatory scope afforded by the FSL may slow down both regulation and enforcement, at least initially, as the DFS' employees will need time to become familiar with areas in which they previously had little or no experience. For example, employees of the current Banking Department may be unfamiliar with insurance law issues and considerations, and vice versa. The employees will also need to become familiar with the new consumer protection measures put into place. The DFS will need to ensure that it has sufficient resources to handle matters that come within its purview, including matters relating to the new fraud investigatory powers described above.

## IV. Supporters of the FSL Believe No Conflict Is Present

Supporters of the new regime created by the FSL believe that a unified regulatory and consumer protection framework is necessary to ensure comprehensive oversight of financial products, services and transactions. The DFS, the new super-regulator, will have a more holistic view of the activities of all companies within a holding company system, regardless of whether they are insurance companies or banks. This will help prevent a recurrence of the events of recent years, which led to the financial crisis. Supporters believe that benefits of the FSL outweigh the initial difficulties, and that the perceived conflict described above is, at best, illusory.

First, while it is true that the DFS will be acting as both regulator and enforcer, at least in the insurance context, these roles are not necessarily contradictory. In fact, according to a article published by the National Association of Insurance Commissioners (NAIC), an organization of insurance regulators from the 50 U.S. states, the District of Columbia and the five U.S. territories providing a forum for the development of uniform policy, the very purpose of existing state insurance regulation is to protect consumers:

> The fundamental reason for government regulation of insurance is to protect American consumers. State systems are accessible and accountable to the public and sensitive to local social and economic conditions. State regulation has proven that it effectively protects consumers and ensures that promises made by insurers are kept.[20]

Ensuring that insurance companies remain solvent and are able to meet their obligations to policyholders is just one way in which current insurance law protects consumers. Furthermore, current insurance regulation already includes consumer protection laws governing company licensing, producer licensing, product regulation, market conduct, and consumer services to handle complaints received about insurance companies and producers.[21] For example, the New York Insurance Department already has a link on its website dedicated to consumer issues, including general information about products, as well as information regarding how to file consumer complaints.[22]

Indeed, historically, the New York Insurance Department has routinely brought consumer protection actions at the same time that it regulates solvency. For example, the Insurance Department recently took disciplinary action against a life and health insurance company for, among other things, failure to include a description of how to appeal a claims denial on the explanation of benefits form to consumers. It also recently took action against a property and casualty insurance company for charging rates in connection with commercial automobile insurance policies, which deviated from filed rates, and for failing to maintain proper procedures to minimize the occurrence of charging incorrect rates.

Therefore, the New York Insurance Department is already in a position to serve as regulator and enforcer for the industry. The DFS' heightened powers are merely a logical expansion of the Insurance Department's existing powers. The fact that funding of the DFS will come from assessments paid by these regulated companies is not relevant, as the assessment provision of the FSL as it applies to insurance companies is largely the same as the existing assessment provision.

Second, the new regime does not compromise the powers of independent actors, such as the New York Attorney General's Office, from investigating and enforcing the law as it applies to insurance, banking and financial services companies and providers. In fact, the FSL expressly contemplates that the DFS Superintendent will cooperate with, assist and, when appropriate, refer matters to the New York Attorney General for the purpose of carrying out its enforcement responsibilities with respect to the protection of consumers.[23] Furthermore, the provisions in the draft legislation granting the DFS Superintendent Martin Act powers were removed from the adopted version of the legislation. This preserves the consumer protection and enforcement functions of independent actors; the new powers granted to the DFS merely augment the existing protection measures.

Further, while the expanded regulatory scope afforded by the FSL may slightly slow down regulation and enforcement initially, the long-term benefits of combining the Insurance and Banking Departments, and affording the new single agency heightened powers, will outweigh any growing pains at the outset. As noted above, the framework for the expanded powers already exists. Current insurance regulation already includes consumer protection provisions, and the New York Insurance Department already has a link on its website dedicated to consumer issues, including general information about how to file consumer complaints. Furthermore, the FSL appropriately preserves regulatory authority and consumer protection functions in other agencies with respect to certain financial products and services. In particular, it expressly carves out the several products from the DFS' jurisdiction.[24] Also, while prior versions of the legislation contemplated merging the consumer financial protection activities of the Consumer Protection Board into the new regime, the adopted version did not include this merger. Instead, the Consumer Protection Board will be replaced by a new Consumer Protection Division in the New York Department of State; it will not be part of the new DFS or FFCPU. This, along with preserving regulation of certain products by other agencies, will ensure that consumer and investor protection issues are appropriately addressed by the agency best poised to do so.

Finally, if managed responsibly, the new combined agency will improve New York's business climate. A single agency will, ultimately, streamline regulation and decision making in the financial service arena. This will improve the ability of sophisticated financial services companies to do business in New York.

## V. Conclusion

The merger of the Insurance and Banking Departments as set forth in the FSL took effect on October 3, 2011. New York is not the first state to pursue a unified financial regulatory system; Florida and New Jersey are among the states that have also merged their insurance and banking departments. However, since New York is a global financial center, changes to its regulatory environment are significant to both domestic and international companies conducting business in New York. While the new DFS may experience some growing pains at the outset, the potential benefits of a single regulator with a holistic view of the financial services landscape are significant and may help curb the type of transactions that led to the recent financial crisis, while simultaneously placing New York on the cutting edge of financial regulation. The full effect of the merger will become more apparent as the year progresses, and the DFS becomes operational. What is clear is that while the future is not certain, it surely has the potential to create a more efficient regulatory regime.

## Endnotes

1. N.Y. Financial Services Law § 102 (FSL).
2. *Id*. § 102(a)–(l).
3. *Id*. § 202(a) ("The head of the department shall be the superintendent of financial services, who shall be appointed by the governor, by and with the advice and consent of the senate, and who shall hold office at the pleasure of the governor. The superintendent shall possess the rights, powers, and duties in connection with financial services and protection in this state, expressed or reasonably implied by this chapter or any other applicable law of this state").
4. Press Release, Governor's Press Office, Governor Cuomo Announces Unanimous Senate Confirmation of Benjamin Lawsky as Superintendent of The Department of Financial Services (May 24, 2011), *available at* <http://www.governor.ny.gov/press/GovernorCuomoAnnouncesUnanimousSenateConfirmation>.
5. FSL § 202(a).
6. *Id*. § 302.
7. *Id*. § 301(c).
8. *Id*. § 203(a).
9. *Id*. § 104(a)(2)(A).
10. *See id*. § 104(a)(2-a).
11. *Id*. § 302(3)(b).
12. *Id*. §§ 401 et seq. Note that the FSL expressly provides that nothing in the new law will be construed as granting the FFCPU the specific powers of the Consumer Protection Division in the New York Department of State. *Id*. at § 404(c).
13. *Id*. § 404.
14. *Id*. at § 404(b) ("If the financial frauds and consumer protection unit has a reasonable suspicion that a person or entity has engaged, or is engaging, in fraud or misconduct with respect to the banking law, the insurance law, the provisions of this chapter or other laws pursuant to which the superintendent has investigatory or enforcement powers, then the superintendent, in the enforcement of relevant statutes and regulations, may undertake an investigation thereon, provided, however, that the scope of authority set forth in this section shall not be deemed to otherwise limit or impair the ability of the superintendent to assist any other entity in an investigation involving a violation of law, and provided further that the responsibility and power to investigate any specific frauds or misconduct enumerated in this chapter, the banking law, the insurance law and other laws pursuant to which the superintendent has investigatory or enforcement powers shall be included under the jurisdiction of the financial frauds and consumer protection unit").
15. *Id*. §§ 404, 408.
16. *Id*. § 408(a)(3)(A).
17. N.Y. Insurance Law § 332 (Ins. Law).
18. *Id*. § 332(a).
19. FLS § 206(a).
20. *See State Insurance Regulation, History, Purpose and Structu*re, *available at* <http://www.naic.org/documents/consumer_state_reg_brief.pdf>.
21. *Id*.
22. *See* Ins. Dep't, State of N.Y., *Information for Consumers*, <http://www.ins.state.ny.us/consindx.htm>.
23. FSL § 301(c)(4).
24. *See supra* p. 4.

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# Inspectors General in Small and Mid-Sized New York Municipalities: A Practical Approach

By Philip A. Zisman

*"Accountability is key to maintaining public trust in our democracy. Inspectors general are entrusted with fostering and promoting accountability and integrity in government."*[1]

## Introduction

In recent years, the New York State Inspector General and other state agencies charged with oversight and accountability[2] have been kept busy investigating the seemingly endless array of scandals emanating from the executive and legislative branches of government. Of course, such scandals are not limited to the state government. Many small and mid-sized New York municipalities have also suffered from crippling financial and ethics scandals. Without an inspector general to call on, however, elected officials in these municipalities have often had to scramble to find ways to deal with both unproven allegations of official misconduct and with the fallout from substantiated findings of wrongdoing. All too often these after-the-fact efforts fail to restore public trust and taxpayers' faith in their local government is diminished further.

Using the City of Yonkers, Department of Inspector General as a model, this article examines the role an inspector general can play in small and mid-sized municipalities, and provides practical information on how to incorporate IG principles into municipal government administration.

## The Yonkers Department of Inspector General

Yonkers, New York, the fourth largest city in the state, has a racially, ethnically, and economically diverse population of approximately 200,000. Because of the city's topography and its reputation for scandals and backroom political deal-making, it has long been referred to derisively as "the city of hills where nothing is on the level." For decades, elected officials have pledged to change Yonkers' image but have had little lasting success.

In 1995, in response to yet another cycle of municipal scandals, the mayor and city council approved legislation making Yonkers the first mid-sized city in the country to create an inspector general's office. Although Yonkers has not yet earned a reputation for open and honest government, by working to prevent abuses and ethics violations that undermine the public trust, the Yonkers Department of Inspector General has been recognized for its significant positive impact on promoting government integrity and improving accountability of both the city's municipal government and the Yonkers Public Schools' administration.[3]

In its effort to root out fraud, waste, abuse and corruption, the Yonkers IG has documented a broad spectrum of misconduct and mismanagement. These include the abuse of overtime, the improper use of take-home vehicles and city gasoline, the cronyism of a former superintendent of schools, and cheating on standardized tests to inflate student test scores. With the advent of the Inspector General as the independent monitor of administrative operations, city and school district officials have had an opportunity to demonstrate that their administrations are indeed "on the level" and meet the highest standards of integrity.[4]

Given its twelve-year record of effectiveness, the Yonkers Inspector General's office can serve as a model for other mid-sized municipalities considering creation of an IG's office and for smaller municipalities seeking ways to incorporate IG concepts into their administrative operations.[5]

## Legislative Authority

Article VII of the Yonkers City Charter §§C7-1-3 establishes the Yonkers Department of Inspector General and sets forth the powers of the office. A summary of the statute is outlined below:

- Sections C7-1-3 of the Yonkers City Charter establish the Department of Inspector General. The IG is appointed by the mayor subject to the advice and consent of the city council, and serves a five-year term of office. The IG can only be removed from office for cause or upon recommendation of the mayor and a two-thirds vote of the city council for removal. The IG must be a lawyer, certified public accountant or otherwise have substantial auditing and investigative experience.
- Section C7-2 grants the IG authority to: 1) make any investigation directed by the mayor or city council; 2) make any investigation or review which in his or her opinion is necessary to uncover any wrongdoing or conflicts of interest in city government; 3) prepare written reports of investigative findings and forward such reports to appropriate authorities; 4) issue subpoenas and conduct hearings; 5) audit

and monitor government operations to ensure that adequate internal control procedures are in place to maximize the efficiency and integrity of agency operations and to reduce vulnerability to fraud, abuse and corruption.

- Section C7-3 requires the full cooperation of all employees with the IG and prohibits anyone from interfering with or obstructing any IG study or investigation. Any violation of this section constitutes cause for suspension or removal from employment.

The Yonkers statute satisfies the core principles necessary for an inspector general to fulfill his or her mandate as the public official responsible for government accountability and oversight. The legislation provides for an independent IG who does not report to the executive or legislative branches of government, although both the city council and mayor are empowered to direct the IG to conduct investigations they deem appropriate. The IG serves for a definite five-year term and can only be removed for cause or upon recommendation of the mayor and a two-thirds vote of the city council. Moreover, the IG is given broad authority, including subpoena powers, to conduct any investigation or review that he or she determines necessary to ensure open and honest government.

## Core Functions of the Yonkers IG's Office—Focus on Auditing

The IG's primary focus is not law enforcement. This is consistent with the city charter, which neither designates the Department of Inspector General as a law enforcement agency nor grants it enforcement powers. Although the IG has broad authority to conduct wide-ranging investigations, any criminal activities uncovered are referred to an appropriate prosecutor. Numerous external law enforcement agencies, including the District Attorney, U.S. Attorney, the Attorney General, the State Comptroller, and the State Organized Crime Task Force have jurisdiction to conduct public corruption investigations and prosecutions in the City of Yonkers. The IG's mandate is to cooperate with these agencies, not to compete with them.

There are also practical reasons why law enforcement is not the primary focus of the office. The IG has a small budget and staff.[6] Its resources are not adequate to conduct complex and often protracted criminal investigations, which can be more appropriately handled by other agencies. The IG can easily consult with law enforcement agencies on criminal matters, and when necessary make appropriate referrals. Prosecutors typically want to show they are actively fighting public corruption, so are generally eager to investigate allegations of official misconduct and welcome referrals from the IG. The city charter also makes it clear that the IG's primary objective is to monitor government and hold public officials accountable for the proper administration of governmental operations. To fulfill this responsibility and monitor government effectively, the IG must concentrate on the audit and review functions.

When the Yonkers Department of Inspector General was established in 1998, it was clear that the city was not in need of another law enforcement agency. There was, however, a pressing need for the creation of an internal audit function within the city and the school district. Many departmental policies and procedures were outdated and inefficient, and many administrative operations had never been subject to an external review or evaluation. There was little objective information on how effectively the city and school administrations were delivering services. Moreover, the limited resources of the Inspector General's office could be used most effectively to conduct specific and discrete audits of the administrative operations most vulnerable to fraud, waste, abuse, and inefficiency.

The objectives of the operational audits are to ensure that there are adequate internal control procedures to promote the efficiency and integrity of agency operations, to make recommendations to management for improving agency effectiveness, and to provide information to elected officials and the public about the detailed workings of a specific municipal operation.

By initially focusing on audits of administrative operations, such as audits of contracts and of the clerk's office, parking violations bureau, assessor's office, and building department, the IG's office was able to integrate itself into the operations of Yonkers City government. Not only did these audits provide the public with information about the inner workings of government, they also provided valuable information and recommendations to department heads on how to run their departments more efficiently and effectively. The audits also facilitated discussions between the IG's office and department heads about administrative problems, and gave the Inspector General an opportunity to answer questions and provide immediate guidance on correcting any deficiencies that were found. In addition, the audits provided a framework for future communications between agency heads and the IG in which the IG could serve as a sounding board to ensure that future agency decisions would be lawful, ethical, and further the public interest. The IG's focus on the audit function did not preclude the office from conducting investigations based on specific allegations of employee or official misconduct. That too remains a core function of the office.

## Core Activities Outside of the Audit Function

Although performance audits have been the central focus of the Yonkers Inspector General's office, there are five additional core activities that the Inspector General regularly performs:

### 1. Investigations into Allegations of Employee and Official Misconduct

According to the Yonkers city charter, the IG shall conduct investigations at the direction of the mayor, city council or as deemed necessary by the Inspector General. Discretionary investigations undertaken by the Inspector General are usually based on complaints or tips (both signed and anonymous), information provided by city officials and employees, information reported in the news media, and information developed independently by the IG's Office through government monitoring efforts. All complaints received by the IG are subject to a preliminary review to determine if a full investigation or audit is required, if the complaint should be referred to another agency with jurisdiction over the matter, or if the matter should be closed because the initial review indicates no further action is warranted.

One of the most significant Yonkers IG investigations was a 2005 investigation into allegations of that the superintendent of schools violated civil service law and school district ethics policy by improperly hiring a friend of his daughter as a highly paid senior accountant. The investigation substantiated the allegation, and, thereafter, the superintendent and the school district chief financial officer were indicted for perjury because they lied under oath to the Inspector General.

### 2. Ethics Investigations and Ethics Counseling

For many years the Yonkers IG served as the city's *de facto* ethicist, and in that capacity rendered numerous opinions interpreting the Yonkers Code of Ethics and other applicable New York State ethics provisions. In this capacity the IG also regularly provided informal ethics advice to public officials and employees.

In 2005, Yonkers adopted a new ethics code that empowered the Board of Ethics to render formal opinions. These new provisions gave the IG joint jurisdiction with the Board of Ethics over investigations that involve allegations of ethical misconduct by city officials or employees. The IG's office conducts such ethics investigations at the request of the Ethics Board or as otherwise deemed appropriate. The IG's findings and recommendations from such investigations are forwarded to the Ethics Board, which is empowered to exact fines of up to $10,000 for substantiated ethics violations.

### 3. Contract Monitoring and Vendor Background Screening

The IG's office monitors Yonkers city and school district contracts. The objective is to ensure the integrity of the city's contracting process, and once a contract is in place, to ensure compliance with contractual terms and conditions. As part of this program, the office conducts background screening of potential vendors in an effort to ensure that only responsible vendors and contractors are hired to provide goods and services to the city and school district. As part of this process, vendors and contractors applying for city contracts must submit vendor background questionnaires ("VBQs"). The VBQs for contracts exceeding $100,000, or for lesser amounts when requested, are verified for accuracy before final contracts are approved.

In verifying VBQ accuracy, the IG's office seeks to discover undisclosed arrests, indictments, convictions, and criminal associations of company principals, as well as disbarments, defaults, suspensions and/or terminations by other government entities. The office also checks for undeclared bankruptcy proceedings and undisclosed investigations involving the vendors. If discrepancies are found in a VBQ, the appropriate city or school district officials are notified. If required, a hearing is held with the vendor.[7] Material misstatements on a VBQ can lead to the disqualification of a vendor for city or school district contracts.

### 4. Review of Community-Based Organizations

Pursuant to a legislative directive of the Yonkers City Council, the Inspector General implements an ongoing program to monitor community-based organizations (CBOs) and other entities that receive grant funding from the City of Yonkers. The IG provides an independent assessment of how city grant funds are being spent.

### 5. Review of Developers' Promises to Provide Community Benefits

To ensure that developers who have received project approvals from the city meet their binding commitments to provide ancillary benefits—agreed to as a condition of development approval—the city council has directed the IG's office to maintain an ongoing oversight program to monitor "community benefits" of development projects. As part of this program, the IG's office identifies specific "community benefits" set forth in the public record that may include the promise to provide jobs, hire minority and women contractors, and to provide affordable housing, and determines whether the developer has met—or is in the process of meeting—these commitments.

## Core Principles in Conducting IG Investigations and Audits

There is very little room for error in any of the work an inspector general undertakes. In almost every investigation or audit, there is the possibility that the findings will have negative consequences for employees and officials found at fault or otherwise criticized. If an IG reports ethics violations, mismanagement or neglect, even when there are no substantiated criminal findings, careers and reputations can be severely damaged. Simply put, because so much is at stake for the people involved, each and every inspector general audit and investigation must be performed meticulously and faultlessly, and all written reports must be clear, concise, and well documented.

In order to meet the highest standards of professionalism and avoid any criticism that an investigation is flawed or biased, an inspector general should adhere strictly to the following principles:[8]

***Independence*—**As IG, establish that you and your office are independent—in fact and in appearance—and focused solely on carrying out the mandates of the office. The IG works in the public's interest and must not be beholden to the executive or legislative branches of government or to any political party.

***Transparency*—**At the outset of all investigations and audits, the IG must set forth the procedures to be followed. Include an explanation of the scope of the report and methodology used in each investigative or audit report. In the course of your work as IG, explain to staff, agency employees, officials, and the public, why you are undertaking the review. Document everything.

***Integrity of the Process*—**The IG's office must handle information with care and without leaks. Treat everyone with impartiality regardless of who is involved. Avoid any conflicts of interest or appearances of such a conflict. Ensure that investigations and audits are comprehensive. Use the full authority granted to the office; do not hold back.

***Develop Good Working Relationships*—**In small and mid-sized municipalities where the number of people employed by and doing business with city government is limited, one works and interacts with the same people repeatedly. Keep relationships professional. Explain your actions as IG. To the extent possible, keep interested parties informed about the status of any review. Try to avoid surprising people. Give commissioners and department heads an opportunity to respond to draft findings and recommendations.

***Review Existing Policies and Procedures*—**Departments within small and mid-sized municipalities may often not have formally established policies and procedures or they may be out-of-date. If none exist, recommend that policies and procedures be established. If antiquated, recommend improvements, which include internal control procedures to safeguard operations. Recommend that supervisors and employees be held accountable for implementing and following the new policies and procedures.

***Utilize a Skilled Forensic Accountant*—**Some IG investigations and audits require sophisticated analysis of voluminous accounting records or raw financial data. It is important to have someone on the IG's team who has the technical expertise to conduct statistical and financial analysis of this information.

***Use Investigations and Audits as an Opportunity to Educate Municipal Officials and the Public*—**As part of an investigation or audit, include background information about the inner workings of the office or administrative function being reviewed. Point out the adequacy of existing internal controls, describe administrative weaknesses, and recognize administrative strengths. As part of the process, give officials and the public an opportunity to learn about the specific government operations under review.

***Make the Report Understandable and Readable*—**To be meaningful, the investigation or audit report must be clear and to the point. In long reports, include an executive summary that sets forth the reasons for the review and lists the findings and recommendations.

***Recommend Solutions*—**An IG's report should not only point out problems; it should also provide realistic solutions. Remember, however, that there are limitations, many of them budgetary, as to what municipal governments can do. Do not recommend solutions that are beyond reach.

***Do Not Duck the Hard Issues*—**Do not avoid controversial issues. Follow the evidence and address all questions presented fairly. To be credible, an inspector general who has the independent discretion to undertake investigations and audits must take on issues important to a municipality's integrity, no matter how controversial or difficult.

***Follow Up*—**If possible, the IG's office should retain jurisdiction over the subject of investigation or audit. Conduct appropriate follow-up audits to ensure problems identified have been addressed.

***Use Your Support Network*—**Ask for help. There is a network of professionals working in the public sector with a wealth of experience in conducting investigations and audits who can provide an IG with valuable assistance. It is important to have others review your work and edit your reports.

## The Benefits of Establishing an IG's Office

In debating whether to establish an inspector general's office, elected officials in small and mid-sized municipalities often claim that the added expense cannot be justified, especially during recessions when budget deficits make it difficult to maintain current programs and services. It is also frequently claimed that the services provided by the IG duplicate those of the finance, law, and police departments.

For small municipalities, the financial arguments may be persuasive because there is unlikely to be enough work to justify a full-time inspector general and a separate staff, however small. However, in cities and counties with annual budgets that exceed several hundred million dollars, the costs of funding the relatively small annual operating budget for an inspector general's office of three or four employees can easily be justified by the considerable benefits and potentially significant savings an inspector general's office can generate. A list of some of these benefits is enumerated below:

***Increased Government Accountability*—**An IG's primary function is to hold government officials and employees accountable to the public. The creation of an independent IG's office provides an important check and balance to ensure that the elected and appointed municipal officials are indeed working in the public interest. The presence of an IG serves as a significant deterrent to officials and employees who might abuse their positions in government.

***An Internal Mechanism to Resolve Disputes*—**An IG's office provides an internal mechanism for resolving disputes based on allegations of misconduct and corruption. In a relatively short period of time, an IG can determine the facts surrounding allegations of wrongdoing by conducting an investigation and issuing a report. The IG can be particularly useful in resolving disputes between the executive and legislative branches of government, disputes that can lead to unproductive, protracted and often expensive legal battles. By having an independent IG conduct necessary investigations and audits, public officials can avoid claims that any such investigations or audits are self-serving or biased.

***Transparency in Government Administration*—**Allegations against public officials involving claims of corruption, ethics violations, and abusive practices are now commonplace. All governments need an orderly process for reviewing such claims and, when necessary, for taking appropriate action. An IG review of such allegations—with a public release of the findings and recommendations—is an important step in ensuring that allegations of misconduct are fully vetted and that the public is kept informed. The IG is also able, in short order, to dispatch specious claims of official or employee misconduct.

***Restoration of the Public Trust*—**After a political or ethics scandal, the public loses faith their local government officials. An IG can help restore public trust. The IG's office can conduct appropriate investigations and audits to address the deficiencies in a government's internal controls that led to the scandal and make recommendations for improving policies and procedures to prevent recurrences. Moreover, the IG can monitor specific areas of municipal operations implicated in a scandal or otherwise deemed susceptible to fraud, waste, and abuse. A meaningful ongoing accountability and oversight program is the only realistic way to restore public confidence in government after it has been tarnished by scandal.

***Deterrence of Crime*—**Much of the workplace fraud committed by government employees are crimes of opportunity, often based on employees' knowledge that administrative operations lack effective internal preventative controls and oversight, leading to a belief that chances of being caught are low. An active IG's office, along with a comprehensive ethics code and whistleblower policies, greatly increase the likelihood of detecting employee crime. As a result, fewer employees will risk engaging in fraudulent activities.

***Cost Savings*—**Although difficult to quantify, the potential deterrent effect of an active IG's office may result in annual savings of thousands of dollars even after factoring in the administrative costs of the office. Further savings can be realized when specific IG recommendations for eliminating waste and abuse are implemented. Moreover, once in place, IGs provide comprehensive and cost-effective, in-house investigative and audit services.

## Recommendations for Officials in Small Municipalities to Consider in an Effort to Incorporate Inspector General Concepts into Their Government's Administration

Most, if not all, local government officials would be quick to assert that under their leadership their administrations are honest, transparent, accountable, efficient, and effective. It is the inspector general's role to verify these claims and confirm the integrity of government. In smaller municipalities, where it may be financially impractical to create an IG's office, elected and appointed officials must still be able to verify claims of transparency and accountability. Listed below are measures that officials of small municipalities can take proactively to incorporate inspector general principles into their governmental administrations:

***Review and Improve Policies and Procedures*—**It is difficult to hold employees and managers accountable without specific standards with which to measure their performance. Officials should ensure that all municipal policies and procedures are up-to-date and contain appropriate internal controls that minimize opportunities for employee fraud, waste, and abuse.

***Open Meeting and Freedom of Information Law Compliance*—**Make it easy for the public to submit Freedom of Information Law (FOIL) requests via email and establish a policy that the municipality will process all FOIL requests as quickly as possible. Make commonly requested documents accessible on the municipality's website. Similarly, ensure that public meetings comply with the Open Meetings Law. Contact the New York State Committee on Open Government for help in understanding and complying with these laws.

***Emphasize Ethics in Government*—**Adopt a comprehensive Code of Ethics implemented by a Board of Ethics. Provide regular ethics training for all municipal employees. Designate an ethicist to provide employees and the public with informal and confidential government ethics guidance so that actions that may constitute ethics violations are avoided.

***Adopt Legislation That Promotes Administrative Integrity*—**Pass legislation or issue an executive order that requires all municipal department heads to maintain and monitor procedures that maximize the effectiveness, efficiency, and integrity of departmental operations in order to reduce government vulnerability to fraud, waste, abuse and conflicts of interest. In the legislation, require department heads to submit annual reports detailing their efforts to ensure the integrity of department operations. Require all employees to report activity that could be considered criminal or corrupt. Require all employees to cooperate fully with any investigation into allegations of misconduct.

***Require Productivity Reporting*—**In addition to integrity reporting, require department heads to issue regular statistical reports quantifying the productivity of their operations. Hold public meetings to review the reports and verify their accuracy.

***Devise a Plan for Addressing Allegations of Official Misconduct*—**Public officials need to be prepared to handle claims of official misconduct and provide an orderly and expeditious process for addressing such allegations. If possible, determine in advance of any such claims who will conduct an appropriate, independent investigation and what procedures will be followed. Require a written, public report of the investigation and its findings unless the release of such a report would violate applicable privacy laws or otherwise compromise an ongoing criminal investigation. Include in the plan the possibility of seeking help from the State Comptroller, the Attorney General or the local district attorney.

***Hire Consultants to Conduct Critical Audits*—**If there are concerns that important municipal operations and programs such as payroll, fringe benefits, and overtime expenditures lack adequate internal controls, hire an external auditor to review these operations or consider asking the State Comptroller to conduct these audits.

***Create an Internal Audit Function in the Finance and Law Departments*—**Expand the missions of the finance and law departments to include performance audits of municipal operations. Although a small municipality may not be able to afford an independent inspector general's office, it may be able to incorporate a performance-auditing component into existing departments.

***Lobby the County Government to Create an Inspector General's Office That Would Be Available to Provide Services to Municipalities Within the County Through Intermunicipal Agreements*—**If an individual municipality is too small to establish its own inspector general's office, an IG would probably be appropriate at the county level. In addition to monitoring county government, a designated county IG could provide services to municipalities within the county in accordance with duly adopted inter-municipal agreements.[9]

Although a smaller municipality may not be able to establish its own inspector general's office, there are many steps that public officials in such municipalities can take to promote the integrity of local governments. These efforts will help build public confidence in local government and demonstrate the commitment of elected and appointed local public officials to open and honest government.

## Endnotes

1. Ass'n of Inspectors Gen., *Principles and Standards for Offices of Inspector General* 3 (2001) ("Green Book").
2. In addition to the Inspector General, the Attorney General, the Comptroller, and the New York State Commission on Public Integrity are all actively engaged in conducting audits and investigations of state government.
3. *See Journal News* Editorial Sept. 3. 2009, "For more than a decade [the] Yonkers Inspector General…has been on the side of the taxpayer, helping to uncover financial waste and malfeasance…"
4. Information on the Yonkers Department of Inspector General and copies of the Department's published reports are *available at* <http://www.yonkersny.gov/Index.aspx?page=94>.
5. Two other mid-sized New York municipalities have experimented with the appointment of an inspector general. In Rochester, the mayor created the Office of Public Integrity, headed by a director/inspector general, which is part of the executive branch of government. Mount Vernon created an office of inspector general by local law in 2008. The models for these offices differ significantly from the Yonkers model, because in both cases the IG is or was part of the executive branch of government and not truly independent.
6. In addition to the IG, the staff includes a deputy inspector general in charge of audits, and a senior investigator. By necessity all staff members are engaged in the substantive work of the department and have skills and training in both investigations and audits.
7. If a municipality is considering disqualifying or debarring a vendor based on integrity concerns, due process requires that the vendor receive an appropriate opportunity to be heard.
8. These principles are based, in part, on Inspector General Glenn Fine, U.S. Dep't of Justice, *Eight Principles for the OIG*.
9. *See* General Municipal Law Article 5-G.

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# The New York City Department of Investigation: A Century of Oversight

By Rose Gill Hearn

This article contains a description of the interesting work of the New York City Department of Investigation, my own experiences as Commissioner these past ten years having been appointed in 2002, and a broad range of reflections and experiences from several former commissioners and a former Mayor.

The purpose and role of the New York City Department of Investigation (DOI) is best understood from knowledge of its history. DOI was born from the corruption scandals that took place in the 1870s. The notorious New York City politician, William "Boss" Tweed, joined forces with other co-conspirators to manipulate the checks and balances in City government and skim millions of City taxpayer dollars. They engaged in bribery, inflated and skimmed from municipal projects, including the building of the Brooklyn Bridge.[1] The outrage over the Tweed ring's blatant fraud, which over a three-year period was estimated to have stolen more than $200 million, led officials to recognize they needed to establish an independent and robust oversight agency to investigate corruption—one that had the statutory powers to take on the City establishment without fear or favor.[2]

In 1873, the State legislature responded by establishing the Office of the Commissioner of Public Accounts, DOI's precursor, as the City's first watchdog created to protect the public's interest. The agency was given the investigative tools it needed to be effective, including subpoena power, the power to examine and remove any books and records of City's agencies, and the power to take testimony under oath.[3] The agency has expanded in size over the years and the name became the *Department of Investigation* in 1938.[4] Over its nearly 140-year history, the agency has evolved as the City has too, although DOI's core mandate remained to investigate fraud, waste and gross mismanagement within and affecting New York City government.[5]

DOI was established to serve the City and its taxpayers as a law enforcement agency that exposes and stops corruption-related crimes, and recovers stolen public funds. Indeed, today the Department recoups millions of taxpayer's dollars each year from its investigations. DOI also uses its role and knowledge of City government for deterrence. That is, DOI works with City agencies, sometimes in the wake of corruption arrests, to close corruption vulnerabilities exposed by DOI investigations. Additionally, in recent years, DOI established a comprehensive outreach and education program, conducting over 500 lectures each year at City agencies and with City contractors about their obligation to report corruption, and their ability to do so confidentially. As Commissioner, I have sought to raise the profile of the Department and conduct it in its tradition as an apolitical anti-corruption office. For the past several years people have contacted DOI in record-high numbers, suggesting the Department's presence has been elevated with the confidence that there will be no reprisal, i.e., last year over 13,000 people contacted DOI on a wide variety of matters. I have a professional, arm's-length relationship with Mayor Bloomberg who is very responsive and supportive of the mission of DOI.

DOI's jurisdictional scope covers all City agencies with the ability to initiate investigations wherever the facts may lead in City government. Given that City agencies are interconnected in many ways themselves, e.g., via budget funding, contracts, personnel and disciplinary rules, databases and substantive missions, DOI's ability to cut across agency lines and collect information, documents, and testimony greatly facilitates its investigations and effectiveness. DOI receives dozens of visiting officials from governments in other cities in the United States and abroad each year, and interestingly, this is because relatively few of them have a citywide anti-corruption agency. DOI hosted a best practices conference in 2008 with inspectors general, government representatives and academics from cities around the United States, to undertake a study of comparative statutory authority and procedures for combating municipal corruption. DOI found that it uniquely provides oversight to a large municipality, i.e., over 45 city agencies, hundreds of thousands of City employees and thousands of contractors.[6]

Former DOI Commissioner Susan E. Shepard, who led the agency from 1990 to 1994 with renowned independence and results, observed about DOI that "[t]he agency pays for itself—literally. With that scorecard, the mystery is why every major city doesn't have [a DOI]."[7]

DOI's multi-faceted approach to combating corruption, its wide-ranging docket of cases, and its staff of approximately 400, is made up of investigators, lawyers, forensic auditors, and computer experts. It refers its criminal findings to New York City's fine cadre of prosecutors—five District Attorneys, the State Attorney General, and the offices of United States Attorney in the Eastern and Southern Districts of New York. DOI's criminal investigations have led to nearly 7,900 arrests since Fiscal Year 1990, with nearly 5,000 of them occurring during my tenure. Those arrests include exposing large-scale corruption cases, such as the recent ongoing *CityTime* probe which found that the multimillion-dollar project to automate the City's time-keeping system was commandeered by fraudsters and consultants, as alleged in the indictment.[8] DOI's investigation of *CityTime* has so far led to charges against 11 defendants and one corporation, the seizing and/or freezing of approximately $50 million, and the return of $2.5 million to the City's coffers. Interestingly, it was the subpoena power imbued on DOI by its forefathers more than a century ago that helped the agency's forensic auditors follow a labyrinthine money trail in today's *CityTime* case and expose the kickback and money laundering schemes that the defendants are charged with concealing through layers of shell companies and sham transactions that reached as far away as India and Latvia.

Last year, DOI also exposed a complex day care fraud ring that reached into three City agencies and resulted in the shuttering of more than 20 day care centers due to safety violations, and nine convictions. The defendants were prosecuted for fraudulently obtaining more than $18 million in benefits intended to help needy families. Separately, investigators found an $8 million food stamp fraud that led to the arrest of four individuals, including two City employees. These notable results produced by the City's own anti-corruption agency would not have been possible in an agency lacking powerful legal authority, independence and support from the City administration.

How DOI has been able to accomplish so much success over the years was explained by former Commissioner Shepard. DOI is the "little agency that could," addressing two of law enforcement's most persistent challenges: how to detect misconduct and how to prevent it from happening again, according to Ms. Shepard. She correctly identifies DOI's great strength as rooted in the expertise of its Inspectors General (IGs) who are fluent in the operations, nomenclature, and inner workings of the City agencies they oversee, and have working relationships with agency employees, giving IGs the in-depth knowledge to identify and understand potential corruption issues in context. Ms. Shepard stated, "DOI embeds Inspectors General in City agencies where they learn the programs and how the agency works and develop relationships with agency employees." Explaining the multi-faceted nature of DOI's role in City government, former Commissioner Shepard added:

> Not surprisingly, Inspectors General are often the first ones to spot problems—and the best qualified to investigate them. At the same time, DOI has developed impressive corruption prevention tools and, with a supportive mayor, the clout to persuade agency commissioners to implement them. If you want to prevent crime, putting the bad guy in jail isn't enough. You have to change agency operational and administrative procedures that invite misconduct. DOI makes criminal cases, but it also has the expertise to develop internal controls which, had they been in place, might have prevented the misconduct in the first place.

That DOI can be effective and resonate within City government only if it is free from political capriciousness was not lost in the aftermath of the Tweed scandals when the agency was created, and subsequently on those who developed DOI's role over the years. The agency's early creators and those who followed ensured that DOI and its Commissioner were imbued with important checks and balances; thus, while the Mayor appoints the DOI Commissioner, the City Council must confirm that appointment, a distinctive feature that creates a safeguard against a Mayoral appointment meant to undermine agency independence.[9] With regard to dismissal of the DOI Commissioner, the Mayor would have to publicly file reasons for the termination, another statutory feature that reinforces DOI's mission to investigate anyone or anything City-related, all the way to the highest levels.[10]

Former DOI Commissioner Nicholas Scoppetta offered vivid recollections and his thought process on the running of DOI, having first been appointed by Mayor John V. Lindsay, and then subsequently reappointed by his successor, Mayor Abraham D. Beame. That was the first time in the City's history that an incoming Mayor reappointed his predecessor's Commissioner of Investigation. I consider that to be a testament to Mr. Scoppetta's caliber and integrity, because obviously Mayor Beame viewed him as the best person for the job, rather than someone else's appointee who should be replaced. Mr. Scoppetta stated that:

> Neither Mayor Lindsay, nor Mayor Beame, ever exerted any political pressure on my office to affect the progress or outcome of any investigation. Nor did either of them ever send me the resume of anyone with a direction that I hire that person. In other words, during my tenure I never felt the slightest suggestion that any of my official duties should be influenced by political considerations.[11]

Drawing on his prior experiences as a state and federal prosecutor and associate counsel for the *Knapp Commission* that famously investigated corruption in the New York City Police Department in the 1970s, Mr. Scoppetta stated that he tried to model DOI on those prior experiences he had gained from "thoroughly professional, independent offices."

Mr. Scoppetta further stated:

> My relationship with both Mayors I served under was excellent, though perhaps a little professionally distant. My way of meeting the statutory requirement that I report investigations and actions by DOI to the

> Mayor was to send over to the Mayor's office a draft copy of the press release announcing an arrest of a city official or a referral to a prosecutor's office. I did this the day before the arrest or referral. I cannot recall an instance in which City Hall made any substantive changes in any of those press releases.

Commissioners Shepard, Scoppetta and I were all prosecutors prior to our respective appointments as DOI Commissioner. As is still very much the case at DOI today, Mr. Scoppetta had close working relationships with area federal and state prosecutors who advance investigations to the next level by, for example, use of grand jury process, wiretaps and filing charges. Specifically, Mr. Scoppetta stated:

> The work of my office was greatly enhanced by partnerships forged with some of the District Attorneys and the two United States Attorneys in New York City. We made frequent and fruitful use of the prosecutor's authority to utilize electronic surveillance in connection with our undercover investigations. In one of those undercover investigations, we created a sham demolition company and had an undercover police officer take the exam for building inspector resulting in [the undercover's] appointment to [the position of building inspector]. That investigation, which stretched over more than 18 months, resulted in more than 100 indictments.[12]

DOI's role has been expanded and shaped by corruption experiences over the years. In the mid-1980s, after a number of corruption cases took place in the City, Mayor Edward I. Koch gave DOI additional legal authorities that strengthened the agency's investigative tools. By Executive Order in 1986, Mayor Koch dramatically changed DOI's composition and power. Up until that point, City agencies had their own internal IGs that reported to and discussed their dockets with the respective commissioners. Recognizing that this arrangement, in part, led to the proliferation of the municipal corruption scandals at several City agencies during his administration, Mayor Koch acted, removing the internal IGs from the City agencies and consolidating them under DOI's supervision. The Executive Order established DOI as the City's single agency to include all the IGs and their staffs, and mandated that all IGs report to the DOI Commissioner. In addition, the Executive Order reiterated that the newly expanded DOI had the discretion to conduct investigations in a confidential matter.

Mayor Koch's insights relating to DOI are grounded in his experiences:

> The role of DOI in New York City has been to constantly be looking to uncover fraud and incompetence, so as to make the government function better. The Mayor cannot depend on district attorneys and U.S. attorneys to constantly be examining city agencies for fraud and other dishonest practices. The DOI Commissioner has the essential assistance of Inspector Generals placed in each agency by DOI and is not dependent solely on whistleblowers. The latter, I believe are a major source of information for outside law enforcement authorities.
>
> I believe having a DOI is extremely important for the purpose of alerting the Mayor to problems early on. Success, of course, depends on the abilities of the Inspector Generals and the Commissioner of DOI. Mayor Bloomberg is being well served by DOI Commissioner Rose Gill Hearn.

Former Commissioner Kevin Frawley served as DOI Commissioner from 1988 through 1990,[13] which was shortly after the *Parking Violations Bureau* corruption scandal that resulted in the federal conviction of Bronx Borough President Stanley Friedman, the suicide while under investigation of Queens Borough President Donald Manes and the convictions of several high-ranking appointed City officials. Mr. Frawley said:

> It was a tumultuous time in New York City government in the third term of Mayor Edward I. Koch's administration. The Mayor was devastated by the dishonesty that was uncovered in City government and was completely supportive of my work and that of my immediate predecessor, Kenneth Conboy. We worked even more closely and intensively than ever before with the FBI, US Attorneys, District Attorneys and New York State Attorney General.

During Mr. Frawley's tenure, numerous successful investigations were jointly and publicly announced "to ensure that citizens through the media could be assured that DOI and the City's government were committed to fighting corruption wherever it was uncovered." Moreover, Mr. Frawley echoed some of the thoughts provided by Mayor Koch about developments during the latter half of the 1980s, and the steps taken at DOI by Mayor Koch as a result. Mr. Frawley indicated:

> Major changes were recommended and implemented beginning in 1986, including substantial increases in funding for new staff and equipment, the restructuring and greater independence of the Inspector General system and the strengthening of

> the Corruption Prevention Unit. Simultaneously, the Mayor appointed a City Charter Revision Commission that studied the role of DOI among other legal and administrative issues. The Mayor and I supported the recommendation of Chairman Richard Ravitch that future DOI commissioners would be subject to the advice and consent of the New York City Council. I believed then and now that this change was needed to provide even stronger independence of DOI within City government as there existed a perception, despite Mayor Koch's unwavering support, that DOI as a Mayoral agency was simply another department of the Administration. It wasn't treated that way by Mayor Koch and [DOI] enjoyed the trust and confidence of all [law] enforcement agencies mentioned above. Nevertheless, the perception was as important as reality and needed to be addressed.

Lastly, former Commissioner Frawley made reference to the creation of the Office of the Special Commissioner of Investigation ("SCI"), which was newly created during his tenure, to conduct investigations of matters at the Board of Education ("BOE").[14] Mayor Koch had convened a proactive Commission to study the corruption problems in the New York City school system, which in its final public report recommended the creation of an external watchdog office under DOI to provide needed independent oversight of the BOE.[15] The Special Commissioner reports to the DOI Commissioner; Richard J. Condon currently occupies the position.[16] SCI has a staff of approximately 60 people, subpoena power through DOI, and conducts investigations into corruption, misconduct and conflicts of interest involving employees of the DOE, e.g., teachers, principals, administrative personnel, custodians, and vendors who do business with the DOE.

In discussing SCI, Mr. Frawley explained that he "was the DOI commissioner who voluntarily transferred one portion of [DOI's] subpoena power to the newly established [SCI] on the recommendation of the esteemed *Gill Commission*. That subpoena power endures today and of course is ably employed by Commissioner Condon under the aegis of your DOI and leadership."

In New York City, employees have an *affirmative* obligation to report corruption taking place in City government pursuant to Executive Order 16, which established that employees of the City must cooperate with a DOI investigation upon penalty of termination for failure to do so.[17] That "must report" obligation evolved from corruption scandals where it was determined that various employees knew that wrongdoing was taking place, but did nothing. The executive order eliminates any question as to whether employees should step forward—by law they must—if they know about corruption. Doing nothing is not an option. These employee tips have become important channels of information about matters that should be investigated.

Complementing the "must report" obligation is the City's whistleblower statute that protects employees who report corruption from retaliation. DOI is charged with investigating any whistleblower allegation made by a City employee and if DOI substantiates a claim, it can request an agency it finds has retaliated against an employee to undo the action. If the agency refuses, DOI can go to the Mayor to direct the agency to do so.[18]

While DOI's criminal cases make headlines, they are but one part of a comprehensive approach that the agency employs to expose, stop, and prevent corruption. So, it is not just about making arrests but also about improving City operations and spurring change where needed so corruption vulnerabilities are remedied rather than repeated. This role was so important that DOI appointed an individual several years ago to track all recommendations that IGs make to City agencies, including how and when they are implemented. Since 2002, DOI has issued more than 2,440 policy and procedure recommendations to City agencies, with 77% of those recommendations implemented to date, representing improvements in City operations across agency lines.

In addition, DOI issues public reports—nearly 20 during my tenure—on its investigations, and posts them on its website, giving the public a factual and accessible window into the agency's work. These reports are a powerful and effective tool for exposing problems in any given sector of City government and for mandating reform. The range of topics covered by these reports has included: DOI's investigation into allegations about a possible slowdown by Department of Sanitation workers during the December 2010 blizzard; exposing the manner by which 14 members of the Fire Department submitted bogus on-line educational degrees in an attempt to earn promotions or appointments; the examination of the deaths of 11 children who were in the care of the City's child welfare system; the squalid conditions maintained at buildings belonging to a Section 8-funded landlord; and two separate reports about schemes involving the theft of public funds from City-funded non-profits that were contractually obligated to provide services to senior citizens and vulnerable populations of children.

These reports and the variety of press releases we issue on developments in DOI investigations create transparency and give the public confidence that the system isn't afraid to bare all and make improvements where necessary.

DOI is also nimble enough to spot trends and target areas of concern that arise during its investigations. In that vein, DOI has created several IG offices over the years for several non-City agencies that have a direct connection to City activities. For example, DOI oversees the large IG offices for New York City's school system, Economic Development Corporation, and the NYC Housing Authority. Additionally, when DOI conducted an investigation involving corruption at the Housing Development Corporation—its then president was convicted and sentenced to prison for defrauding the agency of hundreds of thousands of dollars and child pornography possession—DOI saw the need to establish oversight of the agency, and an IG office was created under DOI's jurisdiction.

Likewise, several years ago, when DOI investigators began uncovering fraud involving publicly funded nonprofits, making numerous criminal cases, we recognized the need for more scrutiny of nonprofits that receive millions of scarce City taxpayer dollars. As a result, DOI formed a nonprofit/vendor fraud unit to focus on the problem and to address the lack of internal controls we discovered in this area. Since its inception in late 2006, the unit has made 37 arrests uncovering fraud and mismanagement at City-funded nonprofits, board members, executives and fiscal employees siphoning hundreds of thousands of taxpayer dollars, and the bogus records about alleged services provided to people in need. In one case, DOI investigated a State Senator and his co-conspirators for financial improprieties at a City-funded Bronx nonprofit. Investigators found hundreds of thousands of dollars paying for personal luxuries for the Senator, who was convicted and sentenced to a prison term.

One powerful example of DOI's impact at an agency can be seen in the Department of Buildings ("DOB"). One of the first problems I faced when I arrived as Commissioner in 2002 was the arrest of 19 DOB inspectors in a large-scale bribery case that wiped out the entire plumbing inspection unit (which inspects gas pipes). Sadly, I learned that event was just one in a series of double-digit arrests of DOB inspectors that had been happening approximately every two years. Indeed, one of the inspectors arrested in 2002 had been previously arrested for bribery and fired from the DOB, then subsequently rehired only to be arrested once again on bribery charges in 2002. The arrest of the 19 inspectors in 2002 caused the City to have to hire a company to conduct scores of re-inspections for safety reasons, at a huge cost.

I chose to have DOI effect change in a number of ways. I asked the Mayor to take the rare step of writing a victim-impact letter to the judge about the real and costly effect of the DOB inspectors' corruption. The judge commented on the letter and sent defendants to jail. Additionally, in every subsequent case DOI sought to arrest not just the City employees who took the bribes, but also the members of the public who offered the payoffs to get around building code regulations. DOI also saturated DOB with anti-corruption lectures informing employees about their obligation to report corruption, and sought termination of an employee who failed to do so.

The emphasis has been working. Since the 19 arrests in 2002, from 2003 through 2010, DOI has arrested another 19 DOB employees on a variety of charges, and more than 270 members of the construction trades on charges relating to DOB matters—and much to our satisfaction, more than 80 of those arrests were the result of DOB employees who turned bribes down and instead *informed* DOI about bribe offers and other illegal conduct. Thus, we had begun to see a change in the culture of corruption, for which we also credit the full cooperation from the DOB and its commissioners. Now, there seems to be a recognition that DOB employees are the first line of defense guarding against corruption and the potential safety hazards that can happen as a consequence.

We also formed the Buildings Special Investigations Unit with the DOB, which is supervised by DOI and staffed with DOB employees. Uniquely formed to identify, investigate, and suspend or revoke buildings licenses of individuals and companies that deliberately violate the City's construction codes causing safety issues, the unit has been successful, investigating and administratively prosecuting more than 390 cases since inception, resulting in $1.3 million in fines and more than 210 revocations or suspensions of licenses of architects, engineers, and others in the construction field.

More than 4,000 corruption prevention lectures have been conducted throughout the City during my tenure, reaching thousands about their obligations and protections in corruption reporting. These lectures are opportunities not just to educate but also to connect with employees on a one-to-one basis and they have also resulted in significant corruption tips. One such tip after a lecture led to a DOI undercover operation that exposed a State Assemblywoman using her official position to obtain a half-million dollar property in Queens. The legislator was charged as a result of DOI's investigation, convicted and sentenced to a prison term. As former Commissioner Scoppetta noted:

> The special knowledge DOI develops about the work and applicable processes within City agencies makes DOI uniquely qualified to investigate activity within those agencies and the people who do business with the City. There is another obligation that DOI has which is to insure the effective delivery of City services. DOI is the Mayoral Agency best equipped to do that.

DOI efforts to make the City whole again from corrupt activity restores services lost to corruption, and addresses illegal activity that have safety implications, including:

- This past year, DOI helped negotiate a $5 million agreement with a large contractor that does business with the City to compensate the City for overcharges on construction projects.
- The agency has been instrumental in exposing and stopping housing tenant fraud, which deprives

those in need of public housing and siphons valuable public housing funds. Since 2002, DOI's housing fraud initiative has resulted in more than 600 tenant fraud arrests and uncovered the theft of more than $13 million in housing benefits. These cases free up scarce public housing units and benefits that eligible people need.

- DOI began an initiative several years ago to track down property owners who had languishing fire code violations, bring those offenders to justice and remedy the violations. This year, DOI expanded that effort to buildings code violations. Together, those initiatives have led to more than 850 arrests resulting in the remediation of the safety violations all around the City, and hundreds of thousands of dollars in fines ordered.

DOI has not only rooted out corruption but has taken on a more expansive role through its corruption prevention lectures, policy and procedure recommendations, and the financial recoveries that are the by-products of its criminal cases. I agree with the collective views of Mayor Koch and former Commissioners Scoppetta, Frawley and Shepard, that DOI should have good working partnerships with area prosecutors; should foster an environment within the City that generates a flow of whistleblower tips; and that our IGs be very vigilant drawing on their knowledge of City agencies to detect and stop corruption in the City.[19] Strengthened by its autonomy, empowered by its authority to look within City agencies, and by virtue of the Administration's support for the mission of integrity in government, DOI has a long history as an anti-corruption agency protecting taxpayers and the public coffers.

## Endnotes

1. Kenneth D. Ackerman, Boss Tweed 66-67 (2005).
2. Richard S. Winslow & David W. Burke, Rogues, Rascals, & Heroes: A History of the New York City Department of Investigation 1 (1992).
3. *Id*. at 5-18.
4. *Id*. at 32.
5. *See, e.g.*, Mayoral Executive Order 16 (July 1978, as amended).
6. Department of Investigation, First New York City National Watchdog Conference (Oct. 2008); *see* New York State Commission on Public Integrity, Symposium, *Watching Local Government: A Comparative Analysis of Inspection and Oversight in American Cities* (2010).
7. Commissioner Shepard was the first woman DOI Commissioner, appointed by Mayor David N. Dinkins. Prior to her appointment, she was an Assistant United States Attorney in the Eastern District of New York, and Chief Counsel to the New York State Commission of Investigation.
8. *U.S. v. Mark Mazer, et al.,* S2 11 Cr. 121 (S.D.N.Y. 2011) (Superseding Indictment).
9. N.Y.C. Charter § 31.
10. N.Y.C. Charter § 801.
11. Commissioner Scoppetta was appointed DOI Commissioner after serving 6 years as an Assistant District Attorney in New York County, under District Attorney Frank S. Hogan, and after serving as Associate Counsel to the Knapp Commission, where he directed an undercover investigation into corruption in the New York City Police Department with a focus on the Narcotics Division. He then joined the United States Attorney's Office for the Southern District of New York to complete that corruption investigation (that investigation was subsequently dramatized in the film, *Prince of the City*).
12. Commissioner Scoppetta also recollected that his tenure

    > was not without its lighter moments. Shortly after Mayor Beame was elected, and pursuant to a Mayoral Directive, I began conducting a series of background investigations on prospective Deputy Mayors, Commissioners and other senior managers. One potential appointee had been dragging his feet responding to my request that he supply me with the documentation he claimed he had that would show he had complied with all applicable laws while he was a state official. Although he was warned that he would not be appointed until he produced the documentation he waited until the night before his swearing in to call me, at about 2a.m., to admit he had no such documentation. I called the newly elected Mayor Beame to tell him that the appointment, scheduled for the next morning, could not go forward. The Mayor's wife, Mary, answered the phone. I told her it was important that I speak with the Mayor. She protested that there was no point in waking him up, that it was 2a.m., and that whatever the problem was he could do nothing about it at that time of the night. She suggested I call him in the morning. While I was insisting that I had to speak to him, I heard Mayor Beame, in the background, asking who was calling. Mary told him it was I and he curtly demanded she give him the phone. As I was apologizing for calling at that hour, I heard Mary Beame, in the background saying, "Oh Abe, Abe, this is going to be a terrible job."

13. Commissioner Frawley was appointed by Mayor Edward I. Koch. Prior to that, he served as the New York City Criminal Justice Coordinator. He noted for this article that his years as DOI Commissioner "were among the best years of my career. I'm very proud of those years, the dedicated men and women who served with me and the contributions we made to fighting corruption in New York City."
14. The Board of Education has been referred to as the Department of Education ("DOE") since 2002 following a change in governance giving the Mayor control of the DOE.
15. N.Y.C. Mayoral Exec. No. Order 11 (1990); N.Y.C. Mayoral Exec. Order No. 34 (1992).
16. Prior to his appointment in 2002 to the position of Special Commissioner, Mr. Condon previously served as New York City Police Commissioner appointed by Mayor Koch, Deputy Coordinator of Criminal Justice for NYC, Commissioner of the Division of Criminal Justice Services for New York State under Governor Mario Cuomo, and Director of Worldwide Security for Paine Webber.
17. N.Y.C. Mayoral Exec. Order No. 16 (1978).
18. N.Y.C. Admin. Code § 12-113.
19. I would like to thank Mayor Koch and Commissioners Scoppetta, Frawley and Shepard for their contributions to this article. While each of us has commented separately over the years about our experiences, this is the first time our views about serving at DOI and/or the importance of role of DOI in City government, were gathered in a single overview.

**Rose Gill Hearn was appointed Commissioner of DOI by Mayor Michael R. Bloomberg and confirmed by the City Council in 2002. She is the longest serving DOI Commissioner in the history of the Department.**

# Assessing a Century of Ethics Laws in New York State

By Blair Horner and Russ Haven[1]

**Blair Horner**

New York has seen a seemingly endless parade of scandals in state government recently, from the merely embarrassing to those that have resulted in felony pleas and convictions, shaking to its very foundations New Yorkers' trust in their government.

The skullduggery involving state political figures uncovered in *just the past six years* includes the resignation of a sitting governor for patronizing a prostitute; felony pleas for the former state comptroller; the conviction of the former Senate Majority Leader for violating the "honest services law"; and a former Assemblyman dying in federal prison while serving time for a hospital shakedown scheme; among others.

*"[L]obbyists and their well-resourced clients are often at the center of government scandals. As a result, lobbying oversight and government ethics go hand-in-hand."*

Most, but far from all, of the scandals involved special interests seeking favors from public officials and/or public officials looking to gain personally from their positions in public office. Since lobbyists and their clients want government action (or inaction), the temptation to make an inappropriate offer or accede to an inappropriate overture apparently has too often proved too great for too many.[2]

With its large budget, now north of $130 billion annually, home to Wall Street and major corporate headquarters, and with among the most generous social and healthcare services available, New York has more registered lobbyists per legislator than any other state and was third highest state in terms of spending on lobbying.[3]

As a result, lobbying is a growth industry in New York. For 2010, the last year for which final data is available, lobby spending in New York was $213.4 million, with 6,659 registered lobbyists representing 4,091 clients.[4] Just a decade earlier, in 2001, lobby spending in the state was $80.4 million and there were 2,930 lobbyists representing 1,640 clients.[5]

To be sure, lobbyists play an important role in government. But they do much more than analyze the issues of the day. Lobbyists are hired and employed to promote the interests of their paying clients and employers. Lobbyists also act as key liaisons between their clients and lawmakers and are tightly woven into political fundraising and electoral campaigns. Thus, lobbyists and their well-resourced clients are often at the center of government scandals. As a result, lobbying oversight and government ethics go hand-in-hand.

**Russ Haven**

Moreover, unlike Congress, state legislators are part-time lawmakers, and many have outside sources of income. According to NYPIRG's review of the most recent ethics disclosures, 64% of legislators reported outside income, including from work as realtors, landlords, lawyers, and a wide range of activities that create the potential for conflict with their public duties.[6]

New York has a long history of addressing integrity in government issues, with each successive measure part of an evolution of greater transparency and accountability for public officials, lobbyists and clients. Reviewing the more recent history in this area allows a better understanding of how the state got to this point and to see how scandals are reflective of their times over the years.

## A Brief History of Lobbying Regulation in New York Since the Dawn of the 20th Century

### The Armstrong Committee

The unseemly side of relationships between lobbyists and public officials and the potential for influence peddling was first put on full display for New Yorkers early in the 20th Century when *The World* newspaper reported on a power struggle within the Equitable Life Assurance Society. The scandal was triggered by the attempt of an Equitable Vice President to sell 502 inherited shares of company stock, which, despite yielding only a few thousand dollars a year in dividends, would cede control of the insurer whose assets were valued at more than $400,000,000.[7] The news reports of cavalier insurance executives living lavish lifestyles outraged the public.

As a result, Governor Francis Wayland Higgins[8] requested a legislative investigation. State Senator Armstrong chaired the investigation committee and tapped future governor and U.S. Supreme Court Justice Charles

Evans Hughes to lead the inquiry. The committee, formally the New York Legislature Joint Committee on Investigation of Life Insurance Companies, is widely known as the Armstrong Committee.[9]

The Hughes-led Armstrong Committee held its first public hearing on September 6, 1905 and released its report on February 22, 1906. The report focused on the dubious practices of the life insurance industry as it existed in the early 1900s, including its legislative affairs.

The report concluded with the recommendation that:

> The pernicious activities of corporate agents in matters of legislation demand that the present freedom of lobbying should be restricted… The Legislature owes it to itself, so far as possible to stop the practice of the lavish expenditure of moneys ostensibly for services in connection with the support of or opposition to bills and generally believed to be used for corrupt purposes.[10]

In just a little over two months after the report was issued, on April 26, 1906, Governor Higgins signed New York's first lobbyist regulations into law.[11] In signing the bill, the governor said it was "to prevent secret lobbying."[12]

The new law required that:

> Every person retained or employed for compensation as counsel or agent by any person, corporation or association to promote or oppose directly or indirectly the passage of bills or resolutions by either house or to promote or oppose executive approval of such bills or resolutions, shall, in each and every year

register with the Secretary of State, with lobbyists reporting on bills they worked on.[13] Contingent lobby contracts were prohibited.[14] Corporations and associations were obliged to file statements within two months after the end of the legislative session to "detail all expenses paid or incurred in connection with legislation." In addition, a new law was enacted to allow the governor to launch broad investigations, now known as a "Moreland Act Commission."[15]

### The Lockwood Committee

In the early 1950s, a major scandal erupted in New York centering on the harness racing industry and involving organized crime figures, prominent Republicans and Democrats, unions and labor racketeering, with two union leaders murdered.

New York's three-term Republican Governor Thomas Dewey responded to the scandal by establishing a Moreland Act Commission to investigate the harness racing industry or "trotters." The Moreland Act Commission found corruption and kickbacks in employer financed union funds.[16] While public officials and political figures had benefited from their ties to the tracks, they were not the focus of the inquiry.

Nevertheless, Governor Dewey called for the creation of a committee to draft a code of ethics to regulate public officials and political leaders when conflicts arise between their public duties and private affairs.[17] A retired state Senator and State Supreme Court Justice, Charles C. Lockwood, was tapped to chair the Special Legislative Committee on Ethics in Government (the "Lockwood Committee").[18]

The Lockwood Committee's recommendations for legislation were passed by the Legislature and signed into law by Governor Dewey in March 1954.[19] These provisions created the core of the state's rules for restricting the business relationships of public officials and staff currently found in the Public Officers Law sections 73 and the code of ethics in Public Officers Law section 74.

## Establishment of the Modern Lobbying and Ethics Laws

### The Regulation of Lobbying Act

In 1976, Governor Hugh Carey created a Moreland Act Commission to investigate allegations of corruption in the licensing and oversight of nursing homes in the state.[20] In addition to newpaper reports, the Moreland Act Commission on Nursing Homes hearings were televised and a seven-volume report was issued in late February 1976.[21] The televised proceedings, in particular, "kept up a climate of public indignation."[22]

Following closely on the heels of the nursing home investigation, in 1977 the Legislature enacted the *Regulation of Lobbying Act*, the state's first comprehensive approach to regulate the activities of lobbyists and their clients.[23] This legislation ushered in the modern era of lobbying oversight and enforcement.

The *Regulation of Lobbying Act* repealed the 1906 lobby laws and established the New York Temporary State Commission on Regulation of Lobbying, and endowed the new entity with investigatory and enforcement powers.

The new Commission was to be bipartisan, consisting of six members, two chosen by the governor (one enrolled Democrat and one Republican), and one each upon nomination of the Majority and Minority Leaders of the Senate, Speaker of the Assembly and Assembly Minority Leader. Commissioners were given three-year terms and could not hold compensated state or local public office, be employed by state or local government, or be subject to the jurisdiction of the Commission.

The Commissioners would select a chairman and vice-chairman of different political parties to serve one-year terms. The executive director was appointed jointly by the chairman and vice-chairman, and served a two-year term concurrent with the legislative session. Lobbyist and client reporting requirements were expanded and the lobby commission was also required to issue an annual report.

Significantly the Commission was given the power to "conduct any investigation necessary to carry out the provisions" of the law, including broad subpoena powers. The lobby commission also could impose penalties and make referrals to appropriate authorities.

**Ethics Reform**

In 1986, wide-ranging scandals coming out of New York City and centering on contracts city agencies had let to private interests for the collection of outstanding city fines, including for Parking Violations Bureau ("PVB") violations, triggered another wave of ethics debate.[24]

The New York City "PVB Scandal" led New York City Mayor Ed Koch and Governor Mario Cuomo to establish the joint city-state Commission on Integrity in Government to "examine instances of corruption, favoritism and conflicts of interest in government and to recommend reforms."[25]

The Legislature rejected the Commission's legislative proposals and passed watered down versions. Governor Mario Cuomo vetoed the legislation as too weak.

After intense new negotiations with the Legislature, Governor Cuomo approved the *Ethics in Government Act.* The new law greatly expanded lawmaker financial disclosures;[26] restricted appearances before state and local agencies; created "revolving-door" regulations to limit the ability of former state officials and employees to lobby erstwhile colleagues; established the state Ethics Commission to oversee executive branch ethics (dominated by gubernatorial appointees); and created the Legislative Ethics Committee (controlled by appointees of the legislative leaders) to oversee legislators' conduct.[27]

## The Lobby Commission Emerges as a Real Watchdog: The Philip Morris Lobbying Scandal

The lobby commission came into its own as a watchdog agency as a result of its investigations into the wining-and-dining activities of tobacco giant Philip Morris, unearthed by researchers among the trove of documents from the global tobacco settlement.[28]

In late 1998, researchers reviewing Minnesota's tobacco document archives came across an astonishing document. According to a Tobacco Institute budget, in 1995 the tobacco industry trade group had spent $279,700 on something called the "New York Preemption Plan."[29] This spending was not reflected in the group's lobbying reports filed with the state. Alerted to this finding, NYPIRG, Common Cause/New York, and the League of Women Voters of New York State, filed a complaint with the New York Temporary State Commission on Lobbying charging that the Tobacco Institute had failed to disclose these expenditures and calling on the Lobbying Commission to investigate.[30]

As a result of the investigation, the Tobacco Institute admitted that it had spent $443,072 in 1995 lobbying in New York and that it had funneled those unreported resources to the New York Tavern and Restaurant Association to advocate on its behalf before both state and local governments.[31]

In July 1999, *The New York Times*, basing its investigation on more documents from the Philip Morris on-line archive, reported that from 1995 through 1997, the tobacco giant spent tens of thousands of dollars on gifts for Albany lawmakers. Internal Philip Morris documents showed that at least 115 current and former legislators of the 211-member Legislature, as well as members of the executive branch, had accepted gifts from the tobacco giant ranging from seats at the men's final of the United States Open tennis tournament, to hotel reservations and tickets to the Indianapolis 500, baseball games and $12,000 in meals for public officials in 1996 alone.[32] In addition, the *Times* also revealed that in 1995 Philip Morris contributed $10,000 to the Hungarian-American Chamber of Commerce, shortly before it underwrote the cost of then-Governor George Pataki's trip to Hungary. The company's top lobbyist joined the Governor and others in Budapest during his trip.[33]

As a result of the investigation by the Lobbying Commission, Philip Morris was fined $75,000 for failing to disclose its lobbying activities as required by law. Its lobbyist was fined $15,000 for her role and banned from lobbying in the state for three years.

The scandal motivated elected officials as never before to show their independence from the tobacco lobby. In late 1999, lawmakers doubled the state's cigarette tax, to the highest in the nation, and earmarked millions for anti-smoking programs. And in 2000, the state enacted first-in-the-nation legislation requiring that cigarettes sold in the state meet fire safety standards.

The scandal also triggered changes to the lobby law, enacted in 2000, which included a tightening of the state's gift restrictions; requiring random audits to verify filings; disclosure of local lobbying activities; and tougher penalties.

Reacting to a number of contracting scandals in 2005, changes were made to the state's lobbying and ethics laws to address problems with the oversight of "procurement lobbying," efforts to obtain contracts to supply state goods and services. The 2005 amendments established procedural safeguards in the procurement process, and closed a loophole that prevented state oversight agencies from pursuing ethics violations against public officials when they left state service.

### Governor Spitzer Pushes to Merge Ethics and Lobbying Oversight

The 2006 gubernatorial campaign focused on promises to change the state's ethical climate. Attorney General Eliot Spitzer won the election in a landslide with sixty-nine per cent of the votes cast and a mandate to change business-as-usual in Albany. Once in office, Spitzer forged an agreement to merge the Ethics and Lobby Commissions into a single new entity, the Commission on Public Integrity. The *Public Employees Ethics Reform Act of 2007*[34] also beefed up penalties and banned more than token gifts from lobbyists and clients to legislators and other public officials.

A concern raised by reform groups was that for the first time a single elected official, in this case the governor, would have a majority of picks on the commission regulating lobbyists. Governor Spitzer responded, saying that if the merged entity stumbled or failed, the public would know he was responsible.[35]

The new Commission on Public Integrity got off to a rocky start, with commissioners recusing themselves at the very first meeting due to conflicts between their private clients and Commission investigations inherited from the previous lobby commission.[36]

As is now well known, Spitzer and his staff soon overreached in attempting to get the upper hand on political rival Senate Majority Leader Joseph Bruno, who was resisting the governor's push for reforms to the state's notoriously lax campaign finance system.

On July 1, 2007, a bombshell article ran in the *Times Union* newspaper detailing how Senator Bruno had repeatedly used state aircraft and vehicles to travel for exclusively or primarily political fundraising, not for public business.[37] Bruno fought back saying that his actions didn't violate the state's lax laws and that it was Spitzer who was out of bounds by using State Police resources to monitor and investigate his activities. The debate and investigations over this controversy became known as "Troopergate."

The Troopergate scandal dominated state headlines and touched off multiple investigations, including by the new Commission on Public Integrity, the state Inspector General, and the Albany County District Attorney.

### The Inspector General's Troopergate Report

A blistering May 2009 report by the Office of the State Inspector General ("IG") found that the Commission on Public Integrity Executive Director broke the law by providing confidential information on the Commission's own Troopergate investigation of the governor's staff by leaking information to the governor's office.[38] The IG's Troopergate Report specifically criticized the Commission's Chairman and Executive Director. Both ultimately resigned.

In reaction to this report, Governor David Paterson appointed a new chairperson and executive director. The Commission found its footing by undertaking an aggressive investigation of Governor Paterson's use of his office to request and obtain tickets to the first game of the 2009 World Series at Yankee Stadium. After an investigation, which included testimony under oath from the governor, top staff and Yankees' personnel, the Commission determined that the governor had lied about soliciting the tickets; had no intention of paying for them; and that he performed no ceremonial public function at the game. In short, he had solicited and received an illegal gift. The Commission fined the governor $62,125.

In light of the scandals engulfing Albany and with Democrats in charge of the state Senate for the first time in decades, both houses of the Legislature were under pressure to produce sweeping ethics reform. Legislation that would have increased legislators' financial disclosure, created separate ethics and lobbying oversight agencies, established a legislative investigations office overseen by the Legislature, and toughened penalties passed both houses. However, Governor Paterson vetoed the legislation saying that it was not strong enough, particularly regarding legislative oversight. A veto override failed in the Senate.[39]

### The 2010 Gubernatorial Election; Cleaning Up Albany Redux

Perhaps not surprisingly, the 2010 race for governor was something of déjà vu all over again: another race for governor, another campaign about who could clean up the ethical morass on the Hudson that was Albany.

The latest round of Albany-based scandals, where sitting legislators were entering plea deals or being indicted on seemingly regular basis, created enormous public pressure to take action to improve the ethical climate of state government.[40]

The common thread running through many of the latest scandals were reports that lawmakers reportedly were making eye-popping amounts of money outside of their legislative jobs in ways that created the appearance, if not reality, of conflicts of interest. These included former Majority Leader Joseph Bruno (running his private consulting business out of his public office and using his leadership position to leverage clients), Assembly member Anthony Seminerio (receiving monies from hospitals in his district for special legislative treatment), and Senator

Pedro Espada (running a health care clinic network in the Bronx and paying himself hundreds of thousands of dollars each year). In these cases and others, it typically has been federal authorities that have taken the lead in investigations and prosecutions.

### The Public Integrity and Reform Act of 2011

The 2011 overhaul of the ethics and lobbying oversight structure and regulatory provisions were designed to shed light on lawmakers' outside business activities and reflects the governor's belief that disclosure is a powerful tool for deterring improper behavior and giving the public insight into how government works.[41] It is also based on the assessment that the Legislature's "self-policing" was no longer acceptable, as well as the belief that no one elected official should control appointments to the state's ethics watchdog.

The *Public Integrity and Reform Act of 2011*[42] was hammered out over the first six months of the legislative session in private negotiations between the governor, the Senate Majority Leader and the Assembly Speaker and their staffs.[43] The legislation will require for the first time that comprehensive, *un-redacted* disclosures be made and available to the public in narrow dollar figure ranges for the governor, attorney general, comptroller and legislators and their policymaking staff.[44] It will establish a new fourteen member Joint Commission on Public Ethics ("JCOPE") to oversee executive branch ethics, lobbyist and client reporting and conduct, and have the ability to investigate, but not punish, legislators. Legislators and staff would remain subject to punishment only by the Legislative Ethics Commission.

The governor appoints six of the fourteen members (with three being enrolled Republicans); the Senate Majority Leader and Speaker each appoint three members; and the Senate and Assembly Minority Leaders each get one appointment.[45] Thus, no one elected official dominates appointments.

The JCOPE chair will be chosen by the governor; the executive director will be chosen by the commissioners, and not have a fixed term, but may only be terminated as specified in statute. Financial penalties are toughened and courts will have the ability to strip corrupt public officials of their pensions.

Under the unprecedented disclosure provisions, lawmakers will have to reveal those clients, including law clients that they directly provide services for and who lobby the state. The state also will establish a database of appearances before state agencies, authorities, boards and commissions, to capture activities by firms where lawmakers have no personal involvement to provide a fuller picture of the influence that firms employing lawmakers may wield.[46]

The *Public Integrity Reform Act of 2011* also for the first time presents the prospect of an outside entity having a statutory role in monitoring and investigating legislators. In order to address separation of powers concerns raised by the Legislature, JCOPE will be able to investigate legislators, but must refer findings of violations to the Legislative Ethics Commission ("LEC") for any punishment. The LEC is subject to a timetable to act or the referral report is made public by JCOPE.

This unprecedented level of disclosure responds to the recent scandals where substantial outside income could have been a tipoff that something was amiss, including the activities of Senator Joseph Bruno, Senator Pedro Espada and Assembly member Anthony Seminerio.

The most controversial aspect of the new Joint Commission on Public Ethics is the extent to which it introduced partisan voting requirements for conducting investigations. The voting requirements reportedly were included to assuage the concern, raised publicly by Republican senators, that JCOPE Commissioners could use the Commission for partisan attacks.

As a result, the new law establishes a special "same branch, same party" rule for voting on matters pertaining to the conduct of legislators, the governor, attorney general and comptroller and their top staff. This provision may prove to be the law's "Achilles heel."

For example, in order to continue an investigation or refer a "substantial basis" finding about an alleged ethics violation by a legislator, legislative employee, or candidate to the Legislative Ethics Commission, there must be at least eight of the 14-member JCOPE Commissioners in support, including at least two Commissioners appointed by legislative leaders of the same party. In other words, at least one appointee of the Senate Majority Leader or the Assembly Speaker would have to support proceeding against a Senate Republican or Assembly Democrat who is under investigation. Similar voting rules apply to statewide elected officials and their direct appointees. This effectively gives those leaders' appointments veto power over enforcement against public officials of their party serving in their branch.

### Lessons from New York's First Hundred Years of Lobbying and Ethics Oversight

New York's history over the past century provides a number of lessons about how reform comes about and what watchdog agencies need to be successful in guarding the public's interest in government integrity. As the public's expectations about how public officials should conduct their affairs shifts and the tolerance for self-dealing diminishes, the standard for ethical conduct will likely evolve in favor of improved disclosure, restrictions on potentially conflicting activities, and tougher penalties.

### Scandals, Media Attention and Advocacy Drive Reforms

Over the past one hundred years, each substantial step forward in ethics reform and the regulation of lobbyists and their clients resulted from scandals that were kept before the public eye. From the 1906 insurance scandal, with one newspaper placing more than one hundred editorials on it, to the televised 1970s nursing home hearings (coming soon after the televised Watergate hearings), to the highly visible scandals that consistently have rocked Albany over the past decade, fixed public attention drives reforms. For the most part, however, the resulting reforms are often tailored closely to address or to appear to address the latest scandal, not necessarily fix other problems.

### Structure and Oversight Independence Are Important

The structure of the oversight body, the independence of the executive director and staff are of critical importance to the functioning of the watchdog agency. For example, leaving control of the Commission on Public Integrity (2007-2011) to a majority chosen by the governor created a real potential for a conflict of interest. Even though the 2007 law granted the commissioners terms of office (a real strength of the law), it also stated that the commission's executive director would serve *at the pleasure of the commission*, with no set term of office. It was clear that this new Commission was at risk of being subject to influence by the governor.

Indeed, the 2009 Inspector General's report painted a picture of how that conflict played out. According to the IG, the Commission's executive director was leaking confidential investigation information to the governor's attorneys. Perhaps it was not surprising that the executive director of a gubernatorally controlled agency, who served at the pleasure of the governor's commission choices, would want to keep the governor in the loop about the investigation into his Administration. While the Commission and the executive director strenuously rejected the conclusions of the IG report, it's not hard to believe how it could have happened. In short, the law provided for a fatally flawed structure of the state's ethics and lobby watchdog agency. The 2011 legislation addressed these concerns by distributing appointments among political leaders. However, the concern with the new law is that the voting requirements may lead to gridlock when political figures or appointees are under investigation.

### The Importance of Transparency Through Disclosure and in Agency Proceedings

From 1906 forward, the clear trajectory has been to increasing disclosure of finances, relationships and activities. These disclosures, with the risk of serious penalties for false entries, can provide clues of where to look for conflicts of interest. And the very existence of disclosure requirements may exert a pressure to reject the conduct or relationships that results in a real or apparent conflict due concerns about appearances. Strong disclosures should have these salutary benefits.

Public trust also is important to the functioning and effectiveness of public integrity watchdogs. These agencies must pursue the facts regardless of fear or favor. If they do so they will have the public's trust and their decisions to act—or forbear from action—will be trusted. The comparative secrecy under which the Commission on Public Integrity conducted its business, including repeated recusals by Commissioners, more time in executive session than in public discussion, and releasing its annual reports electronically without holding news conferences, did not give the public a favorable impression of its watchdog.

In contrast, during his tenure Lobby Commission Executive Director David Grandeau ran a more open agency, including public release of the annual reports and access to case transcripts when an investigation was completed.

At the other end of the spectrum, the Legislative Ethics Commission, and its predecessor the Legislative Ethics Committee, has done very little in the way of investigations or enforcements and has conducted its business almost totally in secret.

With respect to the 2011 changes, agency transparency will depend on the makeup of the new Commission and its executive director and how they determine they will conduct Commission business, in the full public view whenever possible, or in secret to the extent they can. It's our hope that the law's emphasis on transparency of the regulated community will spill over to the proceedings of JCOPE and the Legislative Ethics Commission.

### Somebody Has to Watch the Watchdogs

A prime lesson from the Inspector General's investigation of the Troopergate matter is that checks create balance and it's important to watch the watchdogs. The report came to the highly disturbing conclusion that the Commission on Public Integrity's executive director, the state's top ethics cop, had violated Commission rules and broken the law by leaking information about its investigations and a matter under review by the Albany County District Attorney to the subject of the investigation, in this case the governor.

### People Matter

While agency structure and independence are important—they can promote or inhibit an agency from pursuing its mission—individuals make a huge difference in the way the laws are implemented and the public's interest is served. Individuals like former Lobby Commission Executive Director David Grandeau and former Inspector General Joseph Fisch distinguished themselves through their tenacity and actions regardless of the powerful officials or interests implicated.

Lawmakers would be smart to take an enlightened self-interest and appoint independent, qualified Commissioners with a zeal for achieving the highest ethical standards in government. When government is held in high esteem, when the public trust is upheld, everyone in government basks in that reflective glow. In contrast, everyone in government gets splattered each time a public official is found mucking around in the mud of corruption.

Looking for fresh blood could help. For example, the various appointing authorities to the new JCOPE oversight commission should go beyond the modest restrictions placed on who may serve and look past the highly credentialed group of lawyers that are typically recruited for these positions, but who are more likely to present actual or apparent conflicts and be concerned about their standing in political circles. Academics, clergy, and other citizens without ties to New York's political class all would be excellent choices to serve on a commission whose chief qualification should be common sense and a strong understanding of right and wrong.

> *"When government is held in high esteem, when the public trust is upheld, everyone in government basks in that reflective glow. In contrast, everyone in government gets splattered each time a public official is found mucking around in the mud of corruption."*

## Looking Forward

The *Public Integrity and Reform Act of 2011* presents a fresh opportunity to restore public trust in government and the way decisions are made in Albany. Its detailed disclosure provisions, in particular, will provide a new window into the business relationships and outside income that New York's part-time legislators generate from activities that are supposed to be separate from their public duties. The new law also presents the prospect of outside oversight of the legislative branch, where a disturbing number of the reported scandals have originated in the past few years.

However, the various procedural "safeguards" inserted in the new law as protection from partisan attacks could become an obstacle—particularly if the Commissioners view their jobs as protecting what they believe to be the narrow political interests of those who appointed them.

Whether the new ethics law is working should be evident in the first two years. Early signs will be the quality and independence of the Commissioner appointments, the ability to agree upon a high caliber executive director, the formulation of transparency policies for Commission business and agreement upon the various policy and regulatory decisions to implement the new law. In closing, it's important to be mindful of the long view, that democracy is a work in progress and there is no reform to end all reforms. There will be ethics scandals in the future, the public's tolerance limits will be tested, and more reforms will surely follow.

## Endnotes

1. The authors are grateful for the research contributions of Nicholas Soares, a graduate student in History and Master of Science in Information Science Programs at the Rockefeller College of Public Affairs & Policy at the University at Albany of the State University of New York and a Legislative Associate with NYPIRG for the Spring 2011 semester.
2. Of course the vast majority of legislators and public officials are honest and diligent. The handful of dishonest officials get disproportionate attention and undermine the public's faith in its government. While most lawmakers are not engaged in criminal activity, at least some may abide by the distinction between "honest graft and dishonest graft," attributed to Tammany Hall politician George Washington Plunkitt. *See* History Matters, "*I Seen My Opportunities and I Took 'Em": An Old-Time Pol Preaches Honest Graft*, <http://historymatters.gmu.edu/d/5030/> (last visited Sept. 1, 2011).
3. Sara Laskow, The Ctr. for Pub. Integrity, *State Lobbying Becomes Billion-Dollar Business* (Dec. 20, 2006), <http://projects.publicintegrity.org/hiredguns/report.aspx?aid=835>.
4. Press Release, Comm'n on Pub. Integrity, *Commission on Public Integrity Issues Annual Report* (May 5, 2011), <http://www.nyintegrity.org/pubs/2011/50511_press.html>.
5. N.Y. Temporary State Comm'n on Lobbying, 2001 Annual Report (2002); *see* Richard Perez-Pena, *Jump in Health Care Lobbying, Then in State Health Care Spending*, N.Y. Times, Mar. 21, 2002, *available at* <http://www.nytimes.com/2002/03/21/nyregion/jump-in-health-care-lobbying-then-in-state-health-care-spending.html?scp=1&sq=new%20york%20temporary%20state%20commission%20on%20lobbying%202001%20annual%20report&st=cse>.
6. Celeste Katz, *NYPIRG: Real Estate, Law Are Top Sources of Outside Income for State Lawmakers*, N.Y. Daily News, Jan. 28, 2011, *available at* <http://www.nydailynews.com/blogs/dailypolitics/2011/01/nypirg-real-estate-law-are-top-sources-of-outside-income-for-state-lawmakers>.
7. Merlo J. Pusey, Charles Evans Hughes, Vol. 1, 140-141 (1951).
8. Governor Higgins, previously a state senator and lieutenant governor, served a single two-year term as governor from 1905 to 1907. *See* Nat'l Governor's Ass'n, New York Governor Francis Wayland Higgins, <http://www.nga.org/cms/home/governors/past-governors-bios/page_new_york/col2-content/main-content-list/title_higgins_francis.html>.
9. Joint Comm. on Investigation of Life Ins., N.Y. State Legis. (1906) (the "Armstrong Committee Report").
10. *Id*.
11. *To Curb Lobbyists; Gov. Higgins Signs Insurance Bill Looking to that End*, N.Y. Times, Apr. 27, 1906, *available at* <http://query.nytimes.com/gst/abstract.html?res=9F0CE3D9113EE733A25754C2A9629C946797D6CF&scp=1&sq=new+york+to+curb+lobbyists&st=p>.
12. *Id*.
13. 1906 N.Y. Laws ch. 321.

14. A ban on contingency payments for lobbyists remains a staple of the restrictions on lobbying activity. At its core these prohibitions recognize that bonus payments based upon the success of lobbying create unacceptably high incentives to bend or break ethical rules. Despite being on the books for almost a century, in 2005 the lobby firm of former New York Attorney General Dennis Vacco was fined $50,000 by the lobby commission for violating the contingency ban by entering into a lobby contract that would exchange a $5.5 million success fee payment if a casino gaming license was secured. *See* Tom Precious, *Vacco Firm Pays Fine in Lobbying Investigation*, Buffalo News, Oct. 6, 2005, *available at* <http://findarticles.com/p/news-articles/buffalo-news/mi_8030/is_20051006/vacco-firm-pays-fine-lobbying/ai_n42892942/>.

15. Governor Hughes' inspiration for Moreland Act powers reportedly was born of his inability to remove the state Insurance Superintendent Otto Kelsey from office. *See* Celestine Bohlen, *Moreland Act of 1907: Governors' Strong Suit*, N.Y. Times, Dec. 15, 1988, *available at* <http://www.nytimes.com/1988/12/15/nyregion/moreland-act-of-1907-governors-strong-suit.html> (For a brief history of the Moreland Act, books on its activities, and files related to its investigations between 1915 and 1989, *see* New York State Archives materials *available at* <http://www.archives.nysed.gov/a/research/res_topics_legal_govguide_committees.shtml.> The legislation is named after its sponsor Assembly leader Sherman Moreland).

16. A.H. Raskin, *Track Inquiry Finds Graft in Union Funds*; *Track Study Finds Union Fund Graft*, N.Y. Times, Dec. 16, 1953, *available at* <http://select.nytimes.com/gst/abstract.html?res=FA0811F9355D177B93C4A81789D95F478585F9&scp=1&sq=track+inquiry+finds+graft+in+union+funds&st=p>.

17. *See Text of Dewey's Annual Message to the Legislature Urging Ethics Code for Public Officials*, N.Y. Times, Jan. 7, 1954.

18. Leo Egan, *Dewey to Discuss Racing Scandals*, N.Y. Times, Mar. 12, 1954.

19. 1954 N.Y. Laws ch. 696. The law begins with a statement of legislative intent:

> Declaration of intent. A continuing problem of a free government is the maintenance among its public servants of moral and ethical standards which are worthy and warrant the confidence of the people. The people are entitled to expect from their public servants a set of standards set above the morals of the marketplace. A public official of a free government is entrusted with the welfare, prosperity, security and safety of the people he serves. In return for this trust, the people are entitled to know that no substantial conflict between private interests and official duties exists in those who serve them.

20. Executive Order No. 2, issued Jan. 10, 1975, cited in Patrick J. Dellay, *Curbing Influence Peddling in Albany: The 1987 Ethics in Government Act*, 53 Brook. L. Rev. 1051 (1988).

21. John L. Hess, *The Eternal Nursing-Home Inquiries*; *This Probe Ends With the Promise It Won't Be the Last,* N.Y. Times, May 30, 1976, *available at* <http://query.nytimes.com/mem/archive/pdf?res=F5071FFC3D5B167493C2AA178ED85F428785F9>.

22. *Id*. (This article points out that while a package of nursing home reforms passed in 1976, the ethics proposals that came out of the investigation stalled that year).

23. 1997 N.Y. Laws ch. 937 ("The Regulation of Lobbying Act") repealed N.Y Legis. Law 66, which since 1906 had required registration and reporting of certain lobbying activities to the Secretary of State.

24. Selwyn Raab, *Collection Executive Said to Link Manes to Parking Bureau Payoffs*, N.Y. Times, Jan. 24, 1986.

25. Josh Barbanel, *State-City Panel Appointed to Seek End to Corruption*, N.Y. Times, Mar. 12, 1986, *available at* <http://www.nytimes.com/1986/03/12/nyregion/state-city-panel-appointed-to-seek-end-to-corruption.html?scp=15&sq=michael+sovern+koch+cuomo&st=nyt&pagewanted=print>.

26. The financial disclosures provisions in N.Y. Public Officers Law §73 required reporting on the outside income of state lawmakers to be reported in dollar ranges, but mandated that this information be redacted when publicly disclosed. The 2011 amendments to the state ethics laws will require that financial information be public.

27. Mark A. Uhlig, *2 New York Bills Would Hold Government Officials Accountable for Ethics*, N.Y. Times, Jul. 4, 1987, *available at* <http://www.nytimes.com/1987/07/04/nyregion/2-new-york-bills-would-hold-government-officials-accountable-for-ethics.html?scp=2&sq=ethics+in+government+act+new+york&st=nyt&pagewanted=print>.

28. Clifford J. Levy, *Tobacco Giant Spends Heavily Around Albany*, N.Y. Times, Jul. 27, 1999, <http://www.nytimes.com/1999/07/27/nyregion/tobacco-giant-spends-heavily-around-albany.html?scp=15&sq=philip+morris+lobby+new+york+clifford+levy&st=cse&pagewanted=print>.

29. Tobacco Institute, *1996 Budget-Special Projects* (1996), http://www.tobaccoinstitute.com/.

30. The complaint was made on Sept. 4, 1998 to the Lobby Commission by Common Cause/NY, League of Women Voters/NYS, NYPIRG.

31. Blair Horner et. al, New York's Tobacco Wars: How the Cigarette Companies Conspired to Prevent New York From Cleaning Its Air 13 (2001) (This pamphlet is *available at* <http://legacy.library.ucsf.edu/documentStore/n/a/z/naz00c00/Snaz00c00.pdf>).

32. Levy, *supra* note 28.

33. Clifford Levy, *Tobacco Giant Gave to Backer of Pataki Trips*, N.Y. Times, Sept. 28, 1999, <http://www.nytimes.com/1999/09/28/nyregion/tobacco-giant-gave-to-backer-of-pataki-trips.html?scp=1&sq=Tobacco%20Giant%20Gave%20to%20Backer%20of%20Pataki%20Trips&st=cse>.

34. N.Y. Pub. Off. Law § 73-a.

35. The governor and legislative leaders were well aware that one result of restructuring the lobbying and ethics oversight agency and choosing new commissioners was that then-Executive Director David Grandeau, who was the most effective ethics cop in the state, would end up out of a job.

36. Since the Commission on Public Integrity's start in 2007, several commissioners have come in for criticism due to conflicts of interest. Former Assistant U.S. Attorney for the Northern District Daniel French, appointed by then-Attorney General Andrew Cuomo, recused himself from the first meeting. At the time of his appointment French listed state and federal lobbying among the services provided by his practice; he was representing the Seneca Nation in its land claim and casino negotiations with the state; and he had a client under investigation in relation to the business dealings of Senate Majority Leader Joseph Bruno. *See* Daniel E. Shuey, *Showing Up to Sit Out: Attorney-Commissioners on the New York State Commission on Public Integrity*, 21 Geo. J. Legal Ethics 1025 (2008). Commissioners Richard Emery and Andrew Celli, partners at the time of in a small New York City law firm, represented Democrat Senator Malcolm Smith in litigation over control of the state Senate. *See* Rick Karlin, *Integrity Panel Members Defend Party Jobs*, Times Union, Jun. 13, 2009, *available at* <http://www.highbeam.com/publications/albany-times-union-albany-ny-p408150/jun-13-2009>. Commissioner Emery also came in for criticism for holding a political fundraising party at his home for then Senator (now Attorney General) Eric Schneiderman. *See* Celeste Katz, *Horner: Public Integrity and Fundraising Don't Mix*, N.Y. Daily News, Dec. 3, 2009, <http://www.nydailynews.com/blogs/dailypolitics/2009/12/horner-public-integrity-and-fu.html>.

37. James Odato, *State Flies Bruno to Fundraisers; Taxpayers Finance Trips of Majority Leader to New York City Political Events*, Times Union, July 1, 2007.

38. Office of the Inspector Gen., *An Investigation of an Allegation That Herbert Teitelbaum, Executive Director of the Commission on Public Integrity, Inappropriately Disclosed Confidential Commission Related to Its Troopergate Investigation* (2009).

39. S.6457, 223rd N.Y. Leg. Sess. (Schneiderman)/A.9544, 223rd N.Y. Leg. Sess. (Silver) passed Assembly and Senate January 20, 2010; vetoed February 1, 2010 (Governor's Veto Message No. 1, 2010). A week later the override vote passed the Assembly, but failed in the Senate.

40. The Legislature, in particular the Senate, went through a particularly tumultuous period, including the summer of 2009 "coup," in which two Democrat senators temporarily threw support to the Republicans, causing chaos and a short-term shift in control, before they returned to the Democrat caucus restoring control to that party. One of those senators subsequently was expelled based on his misdemeanor conviction for assault of his girlfriend. The uncertainty and circus atmosphere contributed to the public's low regard of the state Capitol.

41. One of the then-Attorney General Andrew Cuomo's first initiatives was to establish *Project Sunlight*, a combined database for members of the public to research legislation, lobbying and campaign donations as a window on how state government really operates and monitor the public decision making process. The *Project Sunlight* website has been continued under Mr. Cuomo's successor, Attorney General Eric Schneiderman. *See* SunlightNY.com, <http://www.sunlightny.com/snl1/app/index.jsp>.

42. S.5679 224th Leg. Sess. (The Act was indeed signed into law on Aug. 15, 2011).

43. As of writing, the legislation had not been delivered to the governor nor signed into law. For purposes of this article, the authors assumed the legislation was to be enacted by the time this article is published (Ed. Note: The assumption on the part of the authors was accurate).

44. The disclosure forms will have 108 dollar value categories for public officials to indicate their income from various sources, ranging from "none" ("Category A") to "$10,000,000" ("Category DDDDD"). *See* N.Y. Pub. Off. Law § 73-a (3).

45. Under the law even if the Assembly Speaker or Senate Majority Leader—whose party controls the Senate by a one-seat margin—should lose their control of that house, they would still retain their three votes on the Commission notwithstanding their minority status. N.Y. Executive Law § 94(2).

46. Disclosure also was expanded as a check on "front groups" by requiring lobby clients—other than those tax exempt under Internal Revenue Code § 501(c)(3)—including advocacy groups, unions and trade associations, as well as for profit corporations and unincorporated associations, to disclose certain donors of $5,000 or more when these groups meet spending and revenue parameters. Groups exempt under Internal Revenue Code § 501(c)(4) may request a waiver if disclosure of identified donors creates risk of reprisal. *See* N.Y. Legis. Law § 1-h(c)(4).

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# Inspectors General—Evaluating Independence and Increasing Capacity

By Betty B. Vega

Accountability is key to maintaining public trust in our democracy. Inspectors general at all levels of government are entrusted with fostering and promoting accountability and integrity in government. While the scope of this oversight varies among Offices of Inspectors General (OIGs), the level of public trust, and hence public expectation, embodied in these offices remains exceptionally high. The public expects OIGs to hold government officials accountable for efficient, cost-effective government operations and to prevent, detect, identify, expose and eliminate fraud, waste, corruption, illegal acts and abuse. This public expectation is best served by inspectors general when they follow the basic principles of integrity, objectivity, **independence**, confidentiality, professionalism, competence, courage, trust, honesty, fairness, forthrightness, public accountability and respect for others and themselves…inspectors general regard their offices as a public trust, and their prime duty as serving the public interest.[1]

## I. Evaluating Independence

Independence, one of the basic principles for successful, reliable OIGs, is bedrock to serving the public interest. Unless an Inspector General (IG) delivers products and advice that are reliable, accurate, thorough, and complete, the public interest cannot be adequately served. Independence is essential for an IG to deliver those products. The IG's job involves fact-finding, drawing conclusions, and making actionable recommendations about efficiency, effectiveness, compliance or violations of rules, regulations or laws. The IG must "tell it like it is"—no sugar-coating, spinning, slanting, or otherwise distorting information.[2] However, just as the scope of oversight varies among OIGs,[3] so does the meaning of independence for IGs at different levels of government. Also independence may be necessarily limited under some circumstances. In the world of IGs, independence is defined as "free both in fact and appearance from personal, external, and organizational impairments."[4] Some definitions also include the concept of an "independent attitude"[5] which may be the attribute over which the IG has the greatest control.

### A. Personal Impairment

Personal impairments include anything that would cause an apparent or actual conflict of interest such as a personal or close professional relationship with the subject or suspect of an investigation or manager of a program under audit or inspection, or having a financial interest in an entity seeking or doing business with the government that also falls under the scope of the IG's oversight. Personal impairments also include more obscure and harder to detect situations such as strong emotions or personal beliefs for or against a matter; for example, if one were morally opposed to stem cell research how could one in fact and appearance independently conduct an impartial audit of efficient, effective use of funds for the research. An example of a strong emotional impairment would be a situation in which an IG Investigator was lied to under oath by a subject or suspect and is then tasked to re-interview the same subject or suspect for a follow-on matter; most likely there would be concerns that the Investigator may be angry or untrusting from the prior experience, if not in fact then in appearance.

*"The public expects OIGs to hold government officials accountable for efficient, cost-effective government operations and to prevent, detect, identify, expose and eliminate fraud, waste, corruption, illegal acts and abuse."*

Another type of personal impairment includes personal or family stresses or turmoil, or an undiagnosed physical condition such as post traumatic stress syndrome, early on-set Alzheimer's, or traumatic brain injury. These kinds of personal impairments may cause an undue dependence on others or being malleable to control or influence. OIGs "staff are responsible for notifying the appropriate officials within their organization if they have any personal impairments to independence."[6] In this regard, IGs and their staffs are expected and entrusted to self-police. Self-policing for personal impairments requires continuous initiative to know thyself, know thy staff, implement and reward ongoing self-assessment and self-reporting, and openly examine the impairment from several perspectives to include how a third-party would view the facts or appearance. Poor self-policing for personal impairments risks the credibility of the Office to deliver products and advice that are reliable, accurate, thorough, complete, and that serve the public interest. Once credibility is challenged, damaged, or lost, the road to recover is long, arduous and may never lead home. The possibilities for personal impairment to independence are seemingly limitless; however, the IG has a great deal of control over managing and addressing this challenge to independence. Therefore the IG is fully accountable for success or failure to address personal impairment.

### B. External Impairment

External impairments are those forces outside of the OIG that could impede, influence, restrict, or otherwise prevent the IG from independently executing the IG's mission. Examples of external impairments include, but are not limited to: limiting or modifying the scope of the work; exerting pressure or coercion to influence the outcome or results of the work; overruling or influencing facts and findings; restricting, staging or manipulating access to records or to personnel;[7] and undue influence over topics to be examined, methods to be used, timing of, or approach to the work.[8]

### C. Organizational Impairment

Organizational impairments also originate external to the OIG but represent a challenge to the independence from factors driven by the organization that the IG is assigned to oversee. Arguably, most important is the organizational placement of the OIG in relation to the activities or entities subject to the IG's oversight.[9] In general, there are several concepts to organizational independence for the OIG such as placement of the Office outside of the entity under the IG's oversight, at a "different level of government" than the entity, or "a different branch of government within the same level of government."[10] These concepts have different meaning based on context—whether a federal IG, state or state agency IG, or county or city IG.[11] Other concepts and considerations for organizational independence include dual reporting—accountability to the head of the agency (or governor, county commissioner, or mayor) and/or legislative body—report distribution (internal only, external, third-party, the public), and "sufficiently removed from political pressures" and "political reprisal."[12]

Other important components of organizational impairments to independence are: interference in hiring, assigning, promoting, and firing Office personnel; restricting funding and material resources;[13] and in some cases defining or prescribing terms of reference in implementing regulations that may have the effect of limiting the scope of the IG's oversight.[14]

Another important example of organizational impairment is lack of in-house legal counsel dedicated to the OIG. If the IG is required to rely solely on the legal counsel assigned to the agency or other entity subjected to the IG's oversight, there is a conflict of interest present; "an agency general counsel's role is to protect the agency, which is at odds with the IG's role" to "audit, inspect and investigate it."[15] The IG needs legal counsel not only independent from the agency but also focused on the mission of the IG.[16] The Inspector General Reform Act of 2008 requires presidentially appointed and designated federal entity Inspectors General to have their own in-house legal counsel[17] but this issue is unaddressed for IGs at state, county, and city levels of government.

There are additional organizational impairment challenges to IG independence that are more difficult to overcome—performance evaluations, pay, and bonuses for IGs. At the time of this writing, there are no known Inspectors General in the United States that are elected officials. IGs have an appointing authority—the president or agency head for federal IGs, the governor for state and state agency IGs, county commission or board for county IGs, or the mayor for city IGs. An appointing authority or designee (in many cases an agency head) is responsible for evaluating the performance of the IG, and deciding on raises or bonuses. The IG may be able to independently evaluate the performance of Office staff and determine raises and bonuses, but "independence issues arise if the agency head is evaluating IG performance when that evaluation is used as a basis for an increase in the IG's [Inspector's General] pay or for providing a bonus."[18] Currently there is not an agreed-upon solution to this personal and organizational impairment. Some have suggested that IGs not receive pay raises or bonuses during their term of appointment. Others have recommended that IGs should be forbidden from receiving cash awards or bonuses, and that "steps should be taken so that IGs are paid commensurate with the total compensation received by senior staff at their agency."[19] The Inspector General Reform Act of 2008 sets the annual rate of basic pay for presidentially appointed and designated federal entity IGs and also provides a prohibition of cash bonus or awards.[20] These matters are virtually unsettled for state, county, and city IGs.

### D. Limitations Placed on Independence

There are few but prominent examples of limitations placed on IG independence. Seven federal departments and agencies have statutory authority to prohibit IG activities: Department of Defense; Department of Treasury; Department of Homeland Security; Department of Justice; United States Postal Service; Federal Reserve Board; and Central Intelligence Agency.[21] The Inspector General Act (as amended) has granted authority to the heads of seven departments/agencies "to prohibit their respective IGs from carrying out or completing an audit or investigation, or from issuing any subpoena if the head determines that such prohibition is necessary to prevent either the disclosure of certain sensitive information or significant harm to certain national interests."[22] "Permissible reasons for prohibiting IG activities" include: preservation of national security interests; prevention of disclosure of certain information; prevention of significant impairment to national interests; and protection of vital national security interests.[23] Although these words may seem vague to persons not affiliated with these seven departments/agencies, the words have specific meaning within the context of their missions. As a check and balance on this statutory authority to limit IG independence, the Congress included in implementing statutes[24] a Congressional notification process that varies slightly by department or agency.

Although there may be concern that such an authority to limit or restrict the IG could be abused, there has only been one instance of head of agency exercising this authority. In the late 1990s, the U.S. Attorney General directed deferral of the release of a Department of Justice IG report due to sensitive ongoing law enforcement information. Proper notification was made to Congress and at the time when the law enforcement concern was no longer applicable, the Attorney General notified the IG and the report was released publicly (approximately a seven-month delay).[25] The IG noted that the Attorney General made the decision based on balancing interests of the importance of the criminal investigation, role and safety of an informant versus the "benefit of timely release of a report that addressed a topic of significant public concern."[26] At the federal level, the statutory limitations on IG independence by conscientious and measured restriction on IG activities are available if needed, with appropriate checks and balances to prevent abuse, and have rarely been exercised.

### E. Enough or Too Much Independence?

The question has been asked, do IGs have enough independence, or do they have too much independence? It is likely that a majority of IGs would claim they have enough independence to accomplish most of their mission requirements. Rarely would an IG attest to too much independence; however, the agency head may feel differently. In some cases, concerns have been raised that an IG should not have unfettered law enforcement powers because there could be conflicts with existing law enforcement agencies. The answer to this question does not so much depend on the context of the IG Office (federal, state, county, city), but rather how much control does the IG have over the impairments: personal; external; organizational. And how much of a factor is an "independent attitude"?

Personal impairments are very much within the control of the IG. With diligent and continuous self-assessing, policing, and reporting, the IG can minimize the impact of personal impairments to a large degree. External impairments can also be controlled or avoided by the Inspector's General exercise of adequate and consistent protocol, professionalism, competence, written agency business rules or instructions, the weight of the Inspector's General Office, personal power, and just plain stopping it before it starts, exhibiting the "independent attitude" approach.

As for organizational impairments described above, the IG may have little control or ability to change these impairments; organizational change is controlled by appointing authorities, legislatures, and powers outside the IG Office and, possibly, realm of influence. Organizational impairments, as described in this writing (external impairments driven by the organization and imposed upon the Inspector's General Office), are cited over and again as the greatest threat to IG independence, and as reasons why IG Offices are not independent. There is currently no consensus at the federal, state, county, and city levels on general standards for the most difficult issues such as IG performance evaluation and pay.

The plain English definition of independence is "free from influence and control of others."[27] Extensively, organizational impairments are influenced and controlled by others, i.e. the organization, not the IG. This is where the value of the "independent attitude" pays dividends—personal strength and power to stay true to the IG mission, maintain the public trust, and selflessly serve the public interest, even at risk to self and career. As many IG practitioners already know, the "ultimate success or failure of an IG office is largely determined by the **individual IG placed in that office** and that person's ability to maintain personal, external, and organizational independence both in fact and appearance…"[28]

## II. Increasing the Capacity of the Inspector General

There are no definitive measures for determining if an OIG has enough capacity to perform its mission; however when an OIG struggles to perform audits, investigations, and inspections of adequate quality in a timely, useful manner, the lack of capacity becomes obvious. In spite of a lack of capacity metrics, and at least at the federal level where the IG concept is more mature, the IGs "have made a significant difference in federal performance and accountability…billions of dollars in savings to the public and thousands of recommendations and civil and criminal referrals…a solid reputation for preventing and detecting fraud, waste, and abuse; promoting improvements in government operations; and providing helpful analyses on a host of government-wide initiatives…the federal government is a lot better off today because of the IGs' efforts."[29]

To oversee or examine every dollar, every employee, every contract or grant would require that an OIG be staffed and funded comparable to the organization or agency the IG is charged with overseeing—a capacity method that would be overkill, wasteful, and unproductive. One measure that should be examined is the OIG's budget relative to the scope of the oversight the IG is expected to perform, especially given the fact that "the typical organization loses 5% of its annual revenue to fraud."[30] It would not be unreasonable to suggest that the budget for the OIG should be 1% of the budget or revenue for the required scope of oversight, in most contexts, the annual budget for the organization or agency over which the IG has jurisdiction. Spending 1% of an agency's budget to prevent a 5% loss may even be on the low side of adequate IG capacity, given that only a part of the IG mission is to prevent and detect fraud. The IG is also required to detect and prevent abuse, waste and mismanagement as well as promote economy, efficiency, effectiveness, make reports about deficiencies in programs and operations, and keep appointing authorities, legislatures, and the public informed. However, a comparison of agency and OIG budgets at the federal level shows that the OIG on average is funded at approximately 0.2% of the agency's budget.[31] Given this low funding rate to build OIG capacity, it is imperative that the IG prioritizes and appropriately balances IG activities on the most important management challenges, highest risks to the agency's mission accomplishment, and areas most vulnerable to fraud, waste, and abuse.[32] Four suggestions are offered to make the most of the capacity an IG has and to leverage for increased capacity: (1) hone the hotline program; (2) apply capacity to importance through a strategic plan; (3) engage management officials without compromising independence; (4) use techniques to leverage capacity and place more emphasis on prevention.

### A. Hone the Hotline Program

The most common initial detection of fraud is from tips and "tips have repeatedly been shown to be the most effective way to catch fraud."[33] Mechanisms to submit anonymous reports or tips, i.e. "hotlines," have significant impact on the detection of fraud, and "organizations that had fraud hotlines suffered much smaller fraud losses than organizations without hotlines."[34] An estimated 40% of frauds are discovered from tips.[35] "Government agencies had the highest rate of detection by tips"[36]—over 46%.[37] Forty-nine percent (49%) of sources of tips are employees of the organization and are not anonymous.[38] Three times as many frauds have been detected from hotline tips than any other method, including management reviews and planned audits.[39] With this measured impact of hotlines, the hotline program should be viewed with greater importance, staffed by trained, dedicated, experienced staff knowledgeable of the organization. Furthermore, operation of the hotline should not be contracted out but should be viewed as inherently governmental.[40] In addition, the hotline program should be treated as more than just an intake process, but also as a way to ask follow-up questions and through an ongoing dialogue with the tipster, identify information sources, develop leads and witness lists, determine times and places for best observation or surveillance. Tipsters are "one of the most important stakeholder groups for IGs,"[41] therefore quality and ongoing interaction with tipsters may lead to better screening of tips and complaints that help the IG focus activities and capacity on the most important issues, risks, and vulnerabilities.

### B. Apply Capacity to Importance Through a Strategic Plan

A multi-year plan that captures performance, audit, and inspection/evaluation plans in a strategic way is an effective tool to describe, prioritize, and apply IG capacity to the most important known management challenges, highest known risks, and traditional areas of vulnerability to fraud, waste, abuse and mismanagement. At the federal level, "most [IGs] publish a strategic plan at least every three to five years."[42] Conventional wisdom is that plans are made but not followed mainly due to unanticipated events beyond the planner's control. Therefore, the plan should include assumptions, have built-in flexibility, be subjected to re-evaluation at least yearly and viewed as a living document.

There are several methods to determining what should be included in an OIG strategic plan. A useful first step is to determine the current maturity level of the OIG and whether a different level is desired for the future. To determine the maturity level, outcome related to the current workload should be critically assessed. In other words, to what extent does the OIG currently: combat corruption; assure accountability; enhance economy, efficiency, ethics, equity, and effectiveness; increase insight; and facilitate foresight?[43] Once the OIG maturity level is determined, then an OIG strategic plan can be formulated that maintains foundational levels like combating corruption (for example, the hotline program) and assuring accountability, while looking for topics that could raise the maturity level of OIG oversight to increasing insight and facilitating foresight—a difficult maturity level to achieve.

Combining a top-down approach, for example eliciting management challenges and assigning criticality to those challenges, with a bottom-up risk assessment, i.e., surveying the organization to identify risks to mission accomplishment or opportunities for better governance,[44] should fully flush out topics for an OIG strategic plan. A bottom-up risk assessment can be surprisingly revealing because the information comes from those who are trying to achieve the organization's objectives while dealing day-to-day with barriers and gaps that may be unknown to senior leadership.

### C. Engage Management Officials Without Compromising Independence

At least annually the IG should brief senior leadership to: (1) make clear to management officials the unique, independent role and purpose of the Inspector General and brief the contents of the OIG strategic plan; (2) teach and train management officials about effective internal controls, indicators of fraud, trends and schemes in fraud, lessons learned from OIG audits, investigations, inspections/evaluations so that management officials can be active participants in prevention; and (3) familiarize management officials with fraud prevention steps to protect the organization from losses and mismanagement as well as emphasize a "climate/tone at the top of honesty and integrity."[45] Keeping ethics and good governance issues in the forefront of discussions with management officials not only shares essential knowledge but also advances the wisdom of the organization, especially since "one deficiency [in internal controls] is much more common in the million-dollar frauds than in smaller frauds: a poor tone at the top."[46] In addition, spreading the word on results of the IG's work may act as a deterrent.

In some military organizations, teaching and training by the IG is traditionally viewed as being embedded in the functions of inspections, assistance, and investigations. "While inspecting, assisting or investigating, IGs enhance the warfighting and readiness capabilities…by teaching and training commanders, Soldiers, and civilians at all levels on current…policy and doctrine"[47] and by sharing lessons learned and best practices. Because of the wars in Iraq and Afghanistan and the resulting operational demands and losses, military IGs are performing the teach and train function separately from inspections, assistance, and investigations by serving "as a critical substitute for experience when commanders have lost their more experienced officers and noncommissioned officers" and helping "re-establish internal systems that have withered following redeployment"; in particular, IGs use readiness assistance teams to help commanders reset the force. In addition, a crucial teach and train objective is to ensure that personnel at all levels in the organization are aware of the Inspector General "system's purpose, functions, methods, benefits, and constraints" and how the IG system contributes to mission success. "Failure to explain the IG system to commanders and others may result in commanders misusing—or simply not using—their IGs."[48] Some argue that the way in which the military IG system is structured, there is a "lack of any semblance of independence"; however, there are avenues to address situations in which a military IG cannot maintain independence.[49] Military IGs are regarded by their organizations as valuable assets because selection is based on "experience, knowledge, demonstrated maturity, wisdom, and judgment" and possession of a broader perspective than most.[50] Military IGs have shown success in engaging management officials as active participants in prevention without compromising independence, even when using avenues of addressing impairments to independence.

**D. Use Techniques to Leverage Capacity and Place More Emphasis on Prevention**

The use of task forces is an effective way to increase IG capacity especially when the matter for examination falls under several jurisdictions (federal, state, county, city) and the event or matter to be examined is ripe for detection and prosecution of misdeeds. The task force may be made up exclusively of members from various OIGs or the IG may be a member of a task force dedicated to a particular mission. Task forces can be an especially efficient and effective way to leverage expertise and resources when there are a number of organizations, diverse authorities, and multiple funding streams involved. "Good examples of the task forces are the Medicare Fraud Strike Force, Gulf Coast Hurricane-related Fraud Task Force, and the National Procurement Fraud Task Force."[51] Most task forces are utilized in an after-the-fact, reactive way to detect, prevent, and prosecute fraud and abuse.

A contemporary way to leverage expertise and resources in a preventative way is the use of an interagency group or board. The group or board is generally established in advance, or in the early stages of, a planned broad-scope initiative or endeavor that involves participation by several levels of government (federal, state, county, city, federal territory or foreign government) and types of organizations (government, private sector profit and non-profit, citizens). The group or board may be made up entirely of IGs or an IG may be assigned as the group leader. Two good examples of interagency groups or boards are the Interagency Coordination Group of Inspectors General for Guam Realignment and the Recovery Accountability and Transparency Board.

The Interagency Coordination Group of Inspectors General was established by law "to conduct, supervise, and coordinate audits and investigations of the treatment, handling, and expenditure of amounts of appropriated or otherwise made available for military construction on Guam and of the programs, operations, and contracts carried out utilizing such funds.…"[52] In 2006, the United States and the government of Japan agreed to transform the U.S. force posture in Japan in coordination with other realignments in the Pacific. One of the initiatives under this agreement involves relocating 8,000 Marine Corps personnel and 9,000 dependents from Okinawa to Guam.[53] Initial estimates were that this initiative would cost $10.27 billion of which $6.09 billion in cash and financing would be provided by the Japanese government.[54] By law, the Interagency Coordination Group is led by a chairman, the Department of Defense Inspector General. Stakeholders include the Government of Japan, government of Guam, and various U.S. federal agencies: Defense; Education; Health and Human Services; Homeland Security; Interior; Agriculture; Energy; Environmental Protection Agency—each having a member IG on the Interagency Coordination Group. The purpose of the Group is to develop a comprehensive oversight strategy to monitor the use of funds. The chairman is required to report to Congress annually on the Group's efforts and accomplishments.[55] The Interagency Coordination Group is an example of proactively preventing and detecting fraud, waste, abuse, and mismanagement, and promoting efficiency, effectiveness, economy, and a whole-of-government approach to a major initiative by designing oversight before and as the initiative progresses.

The Recovery Accountability and Transparency Board, also established by public law, is charged with overseeing, preventing and detecting fraud, waste, and mismanagement, and provides transparency for the $787 billion of Recovery funds.[56] The Board is chaired by a long-time and well-respected Inspector General and members include twelve federal agency IGs.[57] Another excellent example of interagency-focused effort that increases collective IG capacity, the Recovery Board coordinates and conducts oversight of covered funds, submits reports (quarterly, annual, and flash), recommends measures to prevent fraud, waste, abuse, conducts audits and reviews, maintains a public-facing website "to foster greater accountability and transparency in the use of covered funds," and coordinates oversight activities at the federal, state, and local levels.[58] Collectively, Recovery Board and federal IGs: receive and track complaints of fraud, waste, or abuse which may lead to investigations of wrongdoing or reviews for improving the usage of funds;[59] and provide training on legal and administrative requirements for Recovery programs and preventing fraud, waste, and abuse.[60]

Use of Monitors and Independent Private Sector Inspectors General is another way to increase IG capacity, especially in the area of oversight of contracts or grants. Compliance or Integrity Monitors are not new concepts, but most uses have been confined to corporations that are compelled by court order, deferred prosecution agreement, or non-prosecution agreement.[61] "A monitor's primary responsibility is to assess and monitor a corporation's compliance with the terms of the agreement specifically designed to address and reduce the risk of recurrence of the corporation's misconduct, and not to further punitive goals. A monitor should only be used where appropriate given the facts and circumstances of a particular matter."[62]

Independent Private Sector Inspectors General may be hired voluntarily by organizations or may be compelled by court order, deferred or non-prosecution agreement. The Independent Private Sector IG "possesses legal, auditing, investigative and loss prevention skills, and is truly independent and follows the behavioral guidelines set forth in the code of ethics.…"[63] Currently there are efforts under way to promote the use of Monitors and Independent Private Sector IGs proactively to extend the reach of federal, state, county or city IGs especially in the areas of contract and grant oversight "particularly in high-risk industries and geographically-challenged locations."[64]

## III. Conclusion and Recommended Research

There are many challenges to IG independence that will not be completely eliminated. The keys to success are the Inspector's General ability to exert control over impairments to independence in the context that the IG operates (federal, state, county or city); maintain personal, external, and organizational independence; and exhibit an independent attitude in performance of the IG mission.

There will rarely be sufficient IG capacity to address 100% of the fraud, waste, abuse, mismanagement, economy, efficiency, and effectiveness within an organization. The key is effectively prioritizing IG activities towards most important management challenges, highest risks, and most vulnerable areas through a variety of balanced techniques.

There is sufficient data, information, research and analysis at the federal IG level, mostly connected to periods in time when the Inspector General Act is under review for amendment (usually associated with a significant anniversary of the Act). However, there is sparse if any equivalent data, information, research and analysis for IGs at the state, county, and city levels. Research is needed to identify all the current state, county, city IGs and their appointing authorities; survey challenges and limitations to independence, pay issues, performance evaluation issues, and reporting practices; and determine relationships to appointing authorities, size of budgets and budget process. Only then can specific comparisons and conclusions about their independence and capacity be made.

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# An International Trade "Watchdog": Monitoring Terrorists and Diamonds

By Cecilia L. Gardner

I run a century-old trade organization called the Jewelers Vigilance Committee ("JVC"). Contributions from the various sectors of the jewelry industry finance our work, which is to protect and represent the interests of that industry, primarily by assuring that it complies with applicable laws. Although we share not-for-profit status with groups like Amnesty International, Global Witness, Oxfam, and other civic organizations, we do not claim to represent the public interest. Nonetheless, at least as much as any of them, we have stepped into the breach when government oversight alone could not do the job.

In the mid-1990s, terrorist groups controlled the supply of rough diamonds in Angola and Sierra Leone. To enforce their dominance, the terrorists habitually burned people alive and chopped off the limbs of children and workers in the diamond-producing regions.

The United Nations is the closest approximation we have to a world government. In the late 1990s it issued resolutions and even sent troops to try to combat those terrorists.[1] Its efforts had little effect. We built on those efforts, and succeeded overwhelmingly in ending the terrorists' use of the rough diamond trade to finance their activities and to enrich their members. The monitoring process we initiated and implemented implicitly pointed up the weaknesses of the governmental effort, and resulted in effective oversight.

Business interests motivated us. As a result of a long and brilliant marketing campaign by DeBeers, the preeminent diamond company in the world, customers buy millions of diamonds as "the gift of love."[2] The marketability of polished diamonds relies almost entirely on the aura of that image.

Only a few years prior to the rise of the "conflict diamond" or "blood diamond" terrorists, the fur industry had endured a ferocious assault on its image by People for the Ethical Treatment of Animals (PETA). Estimates vary, but some claim that fur sales dropped fifty percent thereafter.[3]

If diamonds were to become "the gift of chopped-off arms," our industry could suffer similar losses. Thus, when Charmian Gooch of Global Witness approached me in 1999 to ask for our industry's help in combating the terrorists, I understood that as CEO of the JVC, I had to say yes. Little did I know that in order to achieve success, I would have to persuade representatives of numerous nations, industry groups, branches and agencies of government, and even the same NGOs who brought us into the controversy, to support measures that might otherwise seem counterintuitive.

## I. The United Nations: A World Government of Very Limited Powers

Starting in the 1970s, rebels fought a civil war against the government of Angola;[4] financing themselves with the sale of the rough diamonds they terrorized civilians into collecting for them.[5] Starting in 1991, Charles Taylor, then merely a Liberian warlord, later president of Liberia, and eventually a war criminal indicted by the United Nations Special Court in Sierra Leone, sent his terrorists into Sierra Leone to seize control of the rough diamond supply there.[6] In Angola and Sierra Leone, these terrorists frightened the civilians into turning over the rough diamonds by amputating the hands or arms of any who resisted, or burning them alive, or visiting these punishments on their children.[7]

United Nations personnel reported on these developments from the field for several years. While hindsight makes them relatively easy to describe and analyze, the meaning of what the observers heard and saw was not immediately apparent. It took the United Nations several years to understand the role of these "conflict diamonds" in financing the terror as well as motivating it.

In response, the United Nations Security Council enacted resolutions in 1998 and 2000 respectively, forbidding its member nations to import rough diamonds from Angola unless the government certified that they did not come from the terrorist-controlled supply,[8] and from Sierra Leone under any circumstances.[9]

Enactment of the resolutions did not stop the smuggling. South Africa has and had an enormous stake in the profitability of DeBeers, the world's preeminent diamond company.[10] To reduce its risk, the South African government led a delegation of African diamond-producing nations to begin consultations with each other, with the industry, and with the public interest watchdog groups to try to address the problem more effectively. These nations also got the General Assembly of the United Nations to enact its own resolution, beyond the Security Council measures, this time calling on member nations to devise their own measures to stop the trade in conflict diamonds, and "[w]elcoming with appreciation the initiative by the African diamond-producing countries to launch an inclusive consultation process of Governments, industry and civil society, referred to as the Kimberley Process, to deal with the issue."[11]

Ultimately, the Kimberley Process, under the sponsorship of the United Nations, would solve the conflict diamond problem.

## II. The Goal: A System of International Certification

In 1999, Global Witness thought it already had a "solution" to the problem. A member of Congress, Tony Hall (D-Ohio), had drafted legislation proposing that no importer could accept into the United States any diamond worth more than one hundred dollars without accompanying certification of origin showing that the diamond escaped terrorist taint.[12] But Hall's bill could not possibly have worked: the business could not afford to provide such a certificate for every one of the millions of diamonds imported into the United States every year, many of them worth little more than the hundred-dollar minimum.

At the time, DeBeers still exercised such control over the diamond market that each of its "sightholders," the favored few to whom it would deign to distribute its merchandise, would be required to accept and pay for whatever collection of diamonds it saw fit to bestow on that particular recipient. Since each sightholder has a particular customer profile, the set of diamonds that DeBeers had imposed never quite met that profile. Therefore, an essential part of the business involved trading diamonds back and forth so that each customer could end up with the supply best suited to his or her particular preferences. The dealers simply could not keep track of millions of pieces of paper along with all those trades. In any event, since it is chemically impossible to verify the geographical origin of a diamond, the accuracy of the certificates could not be verified.[13]

But a variant certification system could work. A certificate could accompany the parcels in which rough diamonds are exported. The terrorists were the enemies of the governments of Sierra Leone and Angola. Whatever else their faults, those governments would have every incentive to issue certificates only for parcels truly free of conflict diamonds, assuring that no terrorist had exercised control or reaped profit. Certificated parcels would carry only diamonds from mining sites supervised by government officials.

Warranties for polished diamonds would thereafter be based on the parcel certificate, even if the individual diamonds were separated by then.[14] While the original Kimberley Process certificate could identify the geographic source, the warranty could not, but it would suffice since it accompanied the diamonds each time they changed hands. From a business point of view, a diamond without a warranty would command a lower price. Shrewd diamond retailers—meaning virtually all of them—would ignore such inferior goods.

The nature of the business at that time involved its own special protection against fake warranties. The diamond business famously operated on "handshakes." These handshake deals were made at "bourses," or trading houses for diamond dealers. Each major diamond-trading city—New York, Miami, London, Amsterdam, Tel Aviv, Bangkok, Singapore, Bratislava (Slovakia), Mumbai (India), Hong Kong, Shanghai, Moscow, Tokyo, and others[15]—has one. Often they are called the "Diamond Dealers Club," as is the one in New York City. When a diamond dealer is caught attempting to cheat a colleague in a deal, not only does the local bourse expel the dealer, it faxes his name (they are almost uniformly male) and photograph around the world to all the other bourses.[16] This would essentially put the dealer out of business. A dealer trying to pass off a fake warranty would be taking an enormous risk. Very few would think it worth it.

## III. Politicking for a Conflict Diamond Watchdog

So the conflict diamond problem could be solved. A practical system of certification and voluntary warranties for polished could exclude conflict diamonds from the general stream of commerce in the industry, thereby cutting off the terrorists' principal source of financing and motivation. But we could not create the necessary institutional watchdog for monitoring the process without support from the industry, from the governments of concerned countries, and from the not-for-profit critics (the "NGOs") who, if not satisfied, could poison the industry's image with potentially devastating effect on revenues. So building the necessary support for such a system required us to overcome significant obstacles.

The White House itself came to the issue with a negative predisposition. The administration of George H.W. Bush believed in free trade, and would therefore look askance on a process that would impose a new requirement on the importation of any particular type of goods. The very essence of the European Economic Union involved a commitment to reducing barriers to trade among member countries: their representatives would surely have qualms about a system that required that a diamond cut in Amsterdam could not be sent to London without an accompanying warranty. While South Africa, Botswana, and Namibia needed to protect their own very legitimate diamond industries, other African nations, like the Democratic Republic of Congo or Liberia, may reap some profit themselves from transactions involving conflict diamonds, and so were not likely to provide much support. Diamond merchants as a class wanted to defend their "tradition of mystery and secrecy," which for some meant tax evasion and smuggling, and so the industry associations representing them would not immediately welcome the imposition of yet another paper trail. And some of the NGOs seemed to regard criticism as their *raison d'etre*, and thus were reluctant to accept any compromise, even one necessary to the amelioration of a cruel violation of human rights.[17]

The diamond industry's most sophisticated leaders meet annually in Antwerp at the World Diamond Congress. They understood and appreciated the need to resolve the conflict diamond problem. In July 2000 they created the World Diamond Council to meet these challenges, with myself as its general counsel.[18]

First we had to confront the Bush Administration's position. At the request of Member of Congress Amo Houghton (R-N.Y.), who as a member of the Republican majority had introduced the bill noted earlier that Congress Member Tony Hall (D-Ohio) had drafted,[19] the Subcommittee on Trade of the House Ways and Means Committee held hearings on conflict diamonds on October 10, 2001. The Bush Administration, through the testimony of Alan Eastham, the State Department's Special Negotiator for Conflict Diamonds, and James Mendenhall, the Deputy General Counsel to its Trade Representative, communicated its caution, although it continued to support and participate in Kimberley Process negotiations.[20] My testimony, however, and that of Matt Runci, president of Jewelers of America, representing the retailers, made it clear that this was one "restriction on trade" that had the strong support of key sectors of the industry.[21] This may have been a surprise. Since the Bush Administration saw itself as a strong ally of the business community, our testimony as representatives of the industry in question clearly altered the Administration's perceptions.

Other issues surfaced at a meeting of the Kimberley Process in Botswana, where the national, industry, and NGO representatives were negotiating the terms of the Kimberley Process. The NGOs wanted a central secretariat for the Process with inquisitorial powers akin to an international Inspector General, but many of the sub-Saharan African representatives—again, other than those of South Africa, Botswana, and Namibia—along with Russia, absolutely opposed the grant of power to look so closely into their affairs. In fact, the Secretariat that did ultimately emerge had more modest powers,[22] which nonetheless proved sufficient. Similarly, the industry representatives fought off the NGO push for a special entity with investigative and prosecutorial powers to ferret out warranty violations. As noted above, the bourses proved quite capable of providing sufficient enforcement on their own.[23]

India opposed the ban on trade with non-participants, when trade with non-participants would of course have completely undermined the entire impact of the Process. As it turned out, an explicit ban might also have violated the General Agreement on Tariffs and Trade, the 1947 treaty governing the World Trade Organization.[24] China wanted to exclude Taiwan entirely, based purely on its unrelated issues with Taiwan, although Taiwan is a major importer of industrial diamonds, and therefore would almost certainly have turned to the illicit market had it been excluded, again undermining the purpose of the Process. We finessed these objections by assuming that those who would implement the Kimberley Process Accords would in fact ban trade with non-participants and would include Taiwan.

At the next negotiating session, this time in Angola, Alan Eastham, on behalf of the State Department, announced that the United States would refuse to create a new "export authority," which most of the group by then had agreed that each nation would establish to monitor the compliance of its respective domestic diamond trade. At my suggestion, he urged the group to consider some alternative way for signatory nations to assure compliance. Back in Washington, he learned that the Census Bureau in fact tracks each U.S. export and thus could provide a compliance monitoring process. In March 2002 negotiations resumed, this time in Ottawa. There, on expert advice, the group reinstated the explicit ban on trade with non-participants, correctly anticipating that India would drop its objection and that the World Trade Organization would grant a waiver based on peace and security needs,[25] which it did, upon application by Canada and other nations in February 2003.

In July 2002, at a dinner of the American Gem Society, Matt Runci, and I worked on Ambassador J.D. Bindenagel, Alan Eastham's replacement as Special Negotiator for Conflict Diamonds. We explained that with the Census Bureau now meeting the domestic monitoring requirement, the United States could sign on without committing itself to an expensive new bureaucracy.

The full membership of the International Diamond Manufacturers Association and of the World Federation of Diamond Bourses met in London in October 2002. While the sophisticated leaders of the industry understood and accepted the need for the warranty system, many of the members themselves remained deeply suspicious of and unhappy with this new paper trail. Certification of the original container would assure nothing if parcels of rough diamonds were mixed with other rough diamonds lacking certificates. Then the trade in polished diamonds would undermine this system if they were not further covered by the system of warranties. If the industry refused to accept this system of voluntary self-regulation, the Kimberley Process would fail. And at the eleventh hour, the manufacturers and dealers were about to vote it down. I warned of the likely ferocious response by the NGOs. Runci told them that his 10,000-member association of American jewelry retailers had already approved, and warned them that the alternative to self-regulation would be government regulation. At last, the membership approved the System of Warranties and Voluntary Code of Self-Regulation.

Victory seemed short-lived. On October 31, two days later, at the New York Diamond Dealers Club, the president of the Diamond Manufacturers and Importers of America (the "DMIA," yet another industry organization) took a phone call informing him of a mutiny against the agreement by the Israeli and Belgian manufacturers. Finally our work with the State Department paid off. The Ambassador got on the phone to the DMIA president, giving him a message for the Israelis and Belgians: if they did not undertake self-regulation, they would be regulated: the United States would change its rules to prohibit imports unless the foreign manufacturers met U.S. licensing requirements. If the Israelis and Belgians thought that the Bush Administration would back them up in their resistance to this trade restriction, they knew better now. The rebellion was quashed.

On November 5, 2002, in Interlaken, Switzerland, "[r]epresentatives of more than 40 countries, along with mining executives, diamond dealers, and campaigners from advocacy groups, ended two days in a grand hotel below the Alps by committing themselves to a United Nations-backed certification plan intended to insure [sic] that only legally mined rough diamonds, untainted by conflict, reach established markets."[26] As of June 2003, about seventy nations had signed on.[27] As of 2011, Kimberley Process officials claimed to have "reduced the proportion of conflict diamonds in the world trade to 1 percent from 15 percent."[28]

## Conclusion

The Kimberley Process Accords have functioned as effective international law. A consortium of national, industry, and advocacy group representatives, at the invitation of the United Nations, stepped up to solve a problem of international trade and human rights monitoring. Serious abuse had festered unabated in a sector whose participants ranged from the most outrageous outlaws to governments of varying degrees of respectability to venerable commercial establishments. Neither national governments nor the United Nations could address it effectively. It took strenuous lobbying across a wide and varied range of players to craft the solution. Now, a new kind of "watchdog" walks the earth.

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11. G.A. Res. 55/56, U.N. Doc. A/RES/55/56 (Jan. 29, 2001), *available at* <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N00/562/75/PDF/N0056275.pdf?OpenElement>.
12. Clean Diamond Trade Act, H.R. 2722, 107th Cong. (2001), *available at* <http://www.govtrack.us/congress/bill.xpd?bill=h107-2722>. With a Republican majority in the House at that time, Hall had his Republican colleague and friend, Amory Houghton of New York, introduce the bill, to improve its chances of enactment.
13. Feldman, *supra* note 3, at 847.
14. *Conflict Diamonds Hearing*, *supra* note 7 (statement of the Hon. Tony P. Hall, a Representative in Congress from the State of Ohio) (who by this time, October 10, 2001, had come to accept the necessary revisions to his original proposal).
15. *See* World Federation of Diamond Bourses, *available at* <http://www.wfdb.com/index.php?option=com_content&view=category&id=9&Itemid=17>.
16. Feldman, *supra* note 3, at 848-49.
17. *Id*. at 843-44, 848, 854, 860-864.
18. *Id*. at 850.
19. Clean Diamond Trade Act, *supra* note 12.
20. *Conflict Diamonds Hearing*, *supra* note 7 (statements of Alan Eastham, Special Negotiator for Conflict Diamonds, U.S. Department of State, and James E. Mendenhall, Deputy General Counsel, Office of the United States Trade Representative).
21. *Conflict Diamonds Hearing*, *supra* note 7 (statements of Matthew Runci, President and Chief Executive Officer, Jewelers of America, Inc., New York, New York, and Executive Director, World Diamond Council, New York, New York, and Cecilia Gardner, Executive Director, Jeweler's Vigilance Committee, New York, New York, and General Counsel, World Diamond Council, New York, New York).
22. Feldman, *supra* note 3, at 854.
23. *Id*. at 848-49; World Federation of Diamond Bourses, *supra* note 15.
24. General Agreement on Tariffs and Trade art. 3, § 4, October 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194, *available at*: <http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm>.
25. World Trade Org., Master Document art. XXI (1993), *available at* <http://search.wto.org/search?site=English_website&client=english_frontend&proxystylesheet=english_frontend&output=xml_no_dtd&numgm=5&proxyreload=1&ie=ISO-8859-1&oe=ISO-8859-1&q=security>.
26. Alan Cowell, *40 Nations in Accord on "Conflict Diamonds*," N.Y. Times, Nov. 6, 2002, at A6, *available at* <http://www.nytimes.com/2002/11/06/world/40-nations-in-accord-on-conflict-diamonds.html>.
27. Ian Smillie, The Diamonds and Human Security Project, Motherhood, Apple Pie, and False Teeth: Corporate and Social Responsibility in the Diamond Industry 11 (2003), *available at* <http://action.web.ca/home/pac/attach/PAC_CSR_e_.pdf>.
28. Brian Latham & Fred Katerere, *Smuggled-Diamond Revenue Flows to Mugabe's Zimbabwe Before Vote*, Bloomberg, Dec. 28, 2010, *available at* <http://www.bloomberg.com/news/2010-12-28/smuggled-diamond-revenue-flows-to-mugabe-s-zimbabwe-ahead-of-2011-election.html>. Perhaps the Kimberley Process officials overstated its role, but indisputably, the Kimberley Process contributed to the end of the terrorists' power in Angola and Sierra Leone. As Latham and Katerere noted, however, the Kimberley Process has been far less successful in dealing with the more recent problem of terror tactics employed by a government in power, i.e. the government of Zimbabwe. In fact, the Kimberley Process was designed to deal with non-governmental terror, and probably cannot be as effective in this different context.

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# On the Origins and Operations of the Independent Private Sector Inspector General Program

By Ronald Goldstock

In its 1989 report "Corruption and Racketeering in the New York City Construction Industry,"[1] the New York State Organized Crime Task Force discussed the concept of corporate racketeering—"the corrupt domination of markets; bid rigging; bribery of public, union and other officials; false invoicing and other billing frauds; frauds on union pension and welfare funds; tax evasion; and the manipulation and falsification of business records to support these and other crimes." As part of a comprehensive strategy to control racketeering, the Task Force proposed the creation of private inspectors general,[2] to be hired by general or prime contractors to insure compliance with relevant law and regulations, and to prevent fraud and corruption.

The inspiration for that approach was the federal Inspector General Act of 1978 (PL 95-452), codified in 5 AP USC §§ 1 *et seq*.[3] The Act centralized audit and investigative activities in a single "independent and objective" office within each of the major federal departments and agencies; it gave to each Inspector General the responsibility of reporting to the agency head and to the Congress on the magnitude of waste, abuse and fraud within its jurisdiction, proposing remedial action, and deterring future transgressions. Significantly, Inspectors General were also charged in the Act with the promotion of economy, efficiency and effectiveness of the host department and its programs.

Those who have worked within the IG community understand that the structure of the offices of Inspector General as mandated by the Act is far from perfect. Among other issues, there is no statutory provision for hiring individuals with the variety of skills required to accomplish its mandate, and the skills that are provided for are artificially segregated by the requirement that there be separate Assistant IGs for audit and investigations. In fact, the more effective Inspectors General have sought to force cooperation between the skill areas, and to supplement their statutory staffs with a loss prevention component not contemplated by the legislation.

Nevertheless, the IG program has been an undoubted success, and, as early as 1981, it was envisioned that, with a few modifications, that success could be replicated and enhanced within the private sector. Indeed, now, refined and endowed with increased sophistication as the Independent Private Sector Inspector General (IPSIG) program, the concept has found a prominent role in the corporate world.

By definition, an IPSIG is an independent, private sector firm with legal, auditing, investigative, research, analytic, management and loss prevention skills, employed by an organization (voluntarily or by compulsory process) to ensure compliance with relevant law and regulations and to deter, prevent, uncover and report unethical and illegal conduct by, within and against the organization. Where the culture of the organization is primarily legitimate or amenable to reform, the IPSIG may, in addition to the prevention and control of illegal or unethical conduct, be a major participant with management in enhancing the economy, efficiency and effectiveness of the organization. Where the culture is primarily illegitimate and hostile to change, the IPSIG's role may be essentially adversarial, limited to instituting internal controls and monitoring organizational activities.[4]

The relationship between the IPSIG skill areas is symbiotic; the investigative, management and auditing functions generate information concerning actual or potential, waste, abuse and fraud and thus, provide information for loss prevention analysis. The information and analysis leads to the formulation and implementation of appropriate internal controls designed to prevent future illegalities, abuse and inefficiencies, the adherence to which is then monitored by the investigators, researchers and auditors. As with the Federal IG program, the IPSIG must remain independent, autonomous and self-sufficient, and, although interactive with the organization, unconstrained by organizational biases. Thus, to ensure the IPSIG's integrity and credibility as an independent agent, it must have dual reporting responsibility—to the highest levels of the host organization and to an independent body (generally, but not necessarily, a government agency)—and be free to report violations of the law as appropriate.

Despite the inevitable tensions between the operational imperatives of an organization and the IPSIG's cautionary tendencies, the IPSIG is often used by management to make a good organization better, to prevent the corporation from being victimized by commercial entities or corrupt public officials, or to change the ethical culture of an entity capable of such change. For this to happen, however, the IPSIG must institutionally and practically conduct its responsibilities in a manner that respects business realities and the predictably limited "Inspector General toleration" of the host organization. Thus,

- ***The development of new or modified procedures should be undertaken with the full participation of the management and staff of the host organization.*** Human nature permits individuals and their supervisors to accept new approaches if they understand the need for them, believe them to be workable, and have a stake in their success. Thus, credit for the formulation of good ideas should be given to the staff of the host organization (even if not entirely deserved).

- ***Internal controls must be cost-effective and not unduly impede the delivery of goods and services.*** It is clearly possible to design internal controls that would eliminate all waste, abuse and fraud; those internal controls would also stop all production and delivery. Balance is critical; not every violation need be prevented, detected or reported.

- ***In appropriate circumstances, the IPSIG can be used affirmatively to advance the host's business interests.*** Internal controls are designed to stop dishonest people from engaging in corrupt behavior; as noted above, they invariably present hurdles when good people want to do good things. The IPSIG is invaluable for the corporation that seeks to save its honest employees from seeing those controls as obstructions; it can serve as an independent and objective mechanism for waiving certain constraints and monitoring the activity of the corporate activity operating under such waiver. Appropriate sole source contracting under IPSIG oversight is but one example. Of course, by its very nature, the IPSIG helps to advance the host's business interests. The IPSIG protects the host from dishonest employees and unethical vendors, maintains or regains both the fact and image of organizational integrity, and may serve as a legitimate marketing tool.

- ***Self-evaluation that results in the revelation of improper practices should not necessarily be discoverable by competitors and potential litigants.*** While IPSIGs must be free to expose inappropriate behavior by that organization to an independent body, management must be encouraged to use IPSIG services without the fear that its own efforts to enhance corporate integrity will inevitably be used against it. IPSIG reports, therefore, should generally be protected from public disclosure by the IPSIG or government agency.[5] The issue of Qui Tam suits is, of course, problematic for any company which provides its employees or contractors access to internal documents and procedures. It may, however, be possible to contractually provide that while the IPSIG has an obligation to notify the government of its losses through fraud, it may not itself profit from doing so.

All of these features that make the IPSIG what it is—including its unique combination of skills and dual reporting responsibility—make the IPSIG a model vehicle for compliance with the deterrence and detection imperatives of the federal Sentencing Guidelines.[6] Indeed, the philosophy that guides IPSIGs, although preceding the Guidelines, is entirely consistent with them: organizations have a positive responsibility to prevent crime within their ranks, not merely to detect and report it.

Yet, because it is composed of individuals whose futures and career paths are not dependent on pleasing the corporate hierarchy, the IPSIG does not have an institutional bias which might result in the protection of the corporate reputation at the expense of exposing illegal or unethical behavior. The IPSIG program is thus able to serve government interests and leverage government resources in a variety of ways.

- The IPSIG program is an ideal vehicle for reducing waste, abuse and fraud in government contracting and privatization. Where pre-qualification is impractical, IPSIGs can be used to verify qualification information supplied by the winning bidder—at contractor expense. Since any false information supplied would disqualify the contractor and potentially lead to both civil and criminal consequences, such a procedure would vindicate the government's interest in the integrity of the application process. The IPSIG would guarantee that adequate internal controls and appropriate codes of conduct and ethics were developed and internalized so that there was no question of the contractor's obligations. And then, utilizing forensic and compliance audits, inspections, investigations, integrity tests and anonymous hot lines, the IPSIG would insure that the contractor was abiding by relevant laws and regulations as well as the terms of the contract.

- IPSIGs can be used to determine the appropriate restitution or forfeiture in cases where guilt or liability has been proven, but the amount of loss by the victim (or victims) or gain by the perpetrator is not known or is in dispute. Often the government has neither the specific skills nor resources, or may be inappropriately partisan, to determine such amounts accurately and objectively. An IPSIG with access to all necessary records and individuals is perfectly placed to make that determination.

- IPSIGs operating in particular industries have the expertise to evaluate the industry's racketeering susceptibility and potential, to be familiar with illicit schemes commonly practiced by the industry's business community or victimizers, to be aware of the most recent trends, and to help in the design of more effective laws and regulations.

- IPSIG reports often provide investigative predicates leading to law enforcement successes.

- The presence of an IPSIG allows for employment of other approaches designed to reduce illegality or to promote efficiency. For example, in the construction industry, ineffective and often corrupt government inspectors might be replaced by private contractors or through certification by licensed architects and engineers with IPSIG oversight.

- The IPSIG program is ideally suited for organizations engaged in not-for-profit charitable and foundation activities particularly where there is a need to augment the normal government oversight and regulation functions or when government access to private information would be too intrusive. Because the IPSIG reports to both the charity, and to an appropriate government official only when the charity is non-compliant, the IPSIG program provides a mechanism that serves to protect with only minimal governmental intrusion into the affairs of the charity. The IPSIG program is particularly helpful where the organization is community-based and receives substantial contributions from a number of entities (including government or government-aided donors). Even if the various entities were each capable of undertaking an audit of their funding, a dishonest charity would be able to (and, indeed, many have) use a single expense to satisfy multiple donees that "their" funds were appropriately spent. An IPSIG, on the other hand, performing a single comprehensive audit, could not be deceived by such an artifice. Thus, while an IPSIG is a dishonest charity's worst nightmare, it is an enormous benefit to a legitimate charity—at a minimum, enhancing its credibility and thus aiding its fund raising activities. In addition, IPSIGs could be used to determine the bona fides of potential recipients of charitable assets, monitor funds distributed by the host organization, protect the host organization from unscrupulous or inappropriate vendors of goods and services, and reduce inefficiencies in the host organization's operations.

- IPSIGs hold particular promise in the international arena. The internationalization of sophisticated criminal activity is a problem that will become more serious and the increasingly familiar phenomenon of frontiers without borders means that countries and their citizenry will be confronted with companies that they know nothing about seeking to do business with them. IPSIGs may be the perfect vehicle for protecting the host organization from illegalities by their employees, other corporations, and extortive demands by corrupt public officials, but also for assuring the government of the country in which it operates that the organization is real, that it is free from organized crime ownership and influence, and that it has appropriate safeguards to insure that its operation will be in conformity with local law and regulations.

Despite all its advantages, actual and potential, questions are occasionally raised about the IPSIG program. Perhaps the most frequent is the concern that some companies might seek to hire the least aggressive or least competent IPSIG, and that some IPSIGs would find it in their long-term interest to be accommodating to those who offer the prospect of future work. But, similar concerns have not made ineffective SEC regulations involving corporations' relationships with privately retained certified public accountants. Moreover, the IPSIG would be certified and, with dual reporting responsibility, its long-term interests clearly would be in maintaining its reputation, viability and license. And, perhaps most significantly, provisions within the sentencing guidelines requiring an effective program marked by due diligence would make the hiring of an inept or passive company counter-productive. The reverse concern is also occasionally raised, that is, would an IPSIG be too harsh on the host organization in order to demonstrate its toughness? And, of course, the answer is "certainly, it is possible." Indeed, the Grindler memo[7] seeks to establish a role for the Justice Department in the case of federally imposed monitors where there is a dispute between the monitor and host organization.

With respect to any monitor recommendation that the company considers unduly burdensome, impractical, unduly expensive, or otherwise inadvisable, the company need not adopt the recommendation immediately; instead, the company may propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation on which the company and the monitor ultimately do not agree, the views of the company and the monitor shall promptly be brought to the attention of the Department. The Department may consider the monitor's recommendation and the company's reasons for not adopting the recommendation in determining whether the company has fully complied with its obligations under the Agreement.

This is consistent with the IPSIG program being based on the Federal Inspector General Act, which requires the relevant department or agency to report to Congress when there is a disagreement as to the imposition of changes in practice.

One potential means by which IPSIGs might be regulated is through an industry association. Indeed, the International Association of IPSIG (IAIPSIG),[8] whose purpose is to create IPSIG standards and disseminate best practices, has posted a comprehensive Code of Ethics on its website. The Code covers issues relating to independence, conflicts of interest, conflicts with existing professional codes and laws, IPSIG skills and methodology, confidentially, withdrawal of services, and professional obligations.[9] While violations of the Code are to be reported to IAIPSIG, antitrust concerns preclude the Association from undertaking enforcement actions on its own. Nevertheless, consumers of IPSIG's services have made use of the Codes' existence by incorporating its provisions into their RFPs and contracts. For example, New York's Metropolitan Transit Authority, in its "Solicitation Notice" for an "Independent Compliance Monitor," requires that the monitor "conduct its investigations and reviews of the project elements with the highest standard of care and in a manner that is consistent with Generally Accepted Accounting Principles 'applicable to the conduct of similar audits and monitoring activities' and any applicable standards set by the International Association of Independent Private Sector Inspectors General."[10]

If IPSIG oversight is the most frequent issue, the second is inevitably cost. When IPSIGs are voluntarily hired, the economic forces of the market place generally result in a fee that both sides regard as reasonable. But when a corporation, union or other entity is compelled to engage a particular IPSIG, the market dynamics are dramatically different. The imposing authority's main concern is generally that the fee not be inadequate; the host organization is often in an extraordinarily weak bargaining position; and the IPSIG's tendency, as a free market player, is often to maximize revenue and profits. Indeed, even if the latter were not the case, the IPSIG would seek to have an unlimited budget, or at least of a size so that it would not be constrained in its ability to do as effective job as possible.

Nevertheless, the same could be said for public Inspectors General and each of those offices must operate in the context of a budget. A number of factors should be considered in determining the appropriate fee for IPSIG services.

- The fee should be adequate for the IPSIG to complete its assigned tasks. That means, of course, that the scope of work must be understood and the nature of the host agency, in terms of size, geography, complexity, and culture must be taken into account.
- Generally speaking, the fee should approximate what the IPSIG and its component parts (including subcontractors) charge other clients for similar work. Thus, a forensic accountant who charges a standard hourly rate to non-IPSIG clients should not charge more when providing IPSIG services merely because the host organization is not in as good a negotiating position as a regular client.
- The fee should not be so high that the host organization is able to incentivize the IPSIG to ignore its responsibilities or, conversely, to seek to remain in place by unfairly escalating the seriousness of routine issues common to most businesses.
- The imposition of IPSIG services should not be seen as a punishment that is designed to inflict a financial burden on the host organization. The IPSIG should understand that it is spending the monitored entity's money and should develop its investigative and audit strategy and tactics so as to minimize costs consistent with professional standards. That means not auditing every transaction but engaging in random or judgmental sampling. It also means not using three investigators to interview a witness when only two (or one) are necessary.

Thus, to the degree possible, fees charged by imposed IPSIGs should approximate those charged by voluntary IPSIGs, whether it is accomplished by negotiation, competition or regulation. In particular, the work done by appointed IPSIGs should not be duplicative[11] or unreasonable[12] and its discretionary contested billings should be overseen by the appointing agency. In a voluntary situation, the work of a properly utilized IPSIG, promoting economy and efficiency and controlling waste and abuse, should actually provide the host with financial savings. While that may not necessarily be the outcome in every case where the IPSIG has been imposed, it is certainly possible and desirable.

There is no one correct way to choose an IPSIG that will monitor a given company, but there are clearly wrong ways. The IPSIG program must not be, nor be seen, as a means by which government officials, be they regulators, law enforcers or judges, arbitrarily provide lucrative contracts to friends and former colleagues. Generally speaking, IPSIGs should be chosen as a result of an open competition through an RFP or RFQ process. While there will always be some subjectivity in choosing the right person or entity in the provision of professional services, some attempt should be made to impose objective criteria in the selection process. Aside from the standard requirements of competency, integrity and having sufficient time to perform the required functions, consideration should be given to past monitoring experience, special industry expertise, projected costs, depth of the IPSIG team and the ability to commit specific individuals to the assignment over time.

Prequalification programs are often a good way of achieving a pool of potential IPSIGs, the members of which meet the stated requirements and who can be called upon when the need for a monitor arises. Indeed, once a pool has been certified by the imposing agency, the host organization can play a role in the final choice by selecting the monitor either from the entire pool or from a subset thereof. The fact that the IPSIG was, in part, chosen by the host organization may be very helpful in having the organization tolerate the extreme intrusiveness that is inherent in the monitoring process, to adopt the monitor's suggestions for change, and to more readily accept the new organizational culture that is likely to occur as a result of having the IPSIG in place.

It is worth remembering that while the IPSIG program has accomplished much, it is still in its infancy. It is critical that as the program ages, the concerns raised above—and others—be addressed and resolved. The

International Association of Independent Private Sector Inspectors General has made significant advances in providing the industry with a code of ethics and appropriate training. But ultimately it will be up to the membership and the governmental bodies that employ them to ensure that issues are identified and abuses curbed.

## Endnotes

1. N.Y. State Organized Crime Task Force, Corruption and Racketeering in the New York City Construction Industry (New York University Press 1990). The applicability of the "private inspector general" concept to the construction industry was first raised in the Organized Crime Task Force's 1986 Interim Report republished by Cornell University's ILR Press in 1988 (page 94).
2. In fact, the report did not use the term "private inspector general" due to the inelegant acronym that would inevitably result; it instead referred to those entities as Certified Investigative Auditing Firms – an attempt to invoke the image of a [federal] inspector general by designating its constituent parts (see following paragraph in text). Unfortunately, however, the ambiguity of the English language allowed for the term "investigative" to be seen as modifying "auditing," not "firm," suggesting the possibility of a company consisting only of forensic accountants. Thus, there was a final alteration, with the insertion of the words "independent" and "sector" into the original name, hence "Independent Private Sector Inspector General" or "IPSIG." The term "Private Inspector General" (but not the acronym) was used in the interim report (*see id.*).
3. *See generally*, Gates & Knowles, *The Inspector General in the Federal Government: A New Approach to Accountability*," 36 Ala. L. Rev. 473 (1985).
4. Report, International Association of Independent Private Sector Inspectors General.
5. For a comprehensive discussion of this issue, *see* Michael Goldsmith & Chad W. King, *Policing Corporate Crime: The Dilemma of Internal Compliance Programs*, 50 Vand. L. Rev. 1 (1997).
6. 28 USC §§ 991-998; 18 USC §§ 3551-3673. For a comprehensive analysis relating to the rules governing organizations, *see* Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines For Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts About Their Future,* 71 Wash. U. L. Q. 205 (1993).
7. Memo of Gary G. Grindler, Acting Deputy Attorney General, dated May 25, 2010.
8. <http://www.iaipsig.org>.
9. <http://www.iaipsig.org/ethics.html>.
10. MTA Solicitation #: PS833.
11. For example, it generally makes little sense for a Court to appoint an individual as a monitor who then must hire an "IPSIG firm" to do the actual work.
12. The charging of rack rates and the undertaking of unwarranted and unnecessary investigations are unfortunately not unknown.

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# False Claims Acts, City, State, and Federal: Enlisting Citizens to Protect the Fisc

By Gene De Santis and Reannon Froehlich, with editorial assistance by Daniel Levin

Gene De Santis

## Introduction

Governments at all levels (federal, state and local) have historically been plagued by unscrupulous vendors who looted the public purse. During the Civil War, for example, the Union army was victimized by merchants who sold lame horses, defective munitions, and rotten food. An angry President won passage of "Lincoln's Law"[1] on March 2, 1863, to root out the miscreants and stem the financial losses. The law allowed private citizens to sue on the government's behalf ("qui tam") to recoup money from persons that had swindled the government. The citizen who blew the whistle received a bounty of one-half the amount recovered.

*"Qui tam actions brought under the False Claims Act were lauded by fiscal conservatives for safeguarding the public purse and partnering private and government resources to root out fraudulent activity in taxpayer-funded programs."*

The almost century old "False Claims Act" was subsequently crippled by several amendments that dramatically reduced awards for the citizen whistleblower and forbade lawsuits if they were based on any information the government already had, rendering it virtually toothless. The law sat largely fallow until it was rejuvenated under the leadership of Senator Charles Grassley. Senator Grassley and his legislative colleagues bristled after widespread reports of government contractors selling $400 hammers and $600 toilet seats set off a public outcry. Grassley's amendments,[2] signed by President Reagan on October 27, 1986, guaranteed whistleblowers a 15-30% share of the government's recovery, and imposed treble damages against the cheaters. The new law empowered individuals who were in a position to gather evidence and initiate investigations of improper conduct—often before government investigators or auditors were even aware of the corruption.

Qui tam actions brought under the False Claims Act were lauded by fiscal conservatives for safeguarding the public purse and partnering private and government resources to root out fraudulent activity in taxpayer-funded programs. Thus was born the modern day False Claims Act, and a boutique practice known as the "qui tam" bar.

Reannon Froehlich

## Federal False Claims Act

The federal False Claims Act allows whistleblowers to bring suits under seal in the name of the government—qui tam actions—against parties that have committed fraud against it. The risks incurred by the individual whistleblower are great—by speaking against his or her employer, employees are likely to be terminated and black-listed in their profession—so the law created substantial incentives to speak out.

To encourage an individual who understands the fraud and has access to evidence to support a fraud charge to come forward (the "relator"), the statute provides a financial incentive (generally 15-30% of the award) to those willing to take the time to assist in investigations and endure the emotional and financial stress involved in bringing suit. This also means that whistleblowers will generally only come forward when substantial evidence exists to support the claim. At the same time, the False Claims Act encourages a race to the courthouse; therefore, employees who suspect fraud are more inclined to investigate their suspicions rather than turning a blind eye to questionable conduct.[3] While the compensation awards can be substantial, the statute also provides for triple damages so the state is "made whole" for the costs of investigation, lost interest and whistleblower awards on top of what was taken by fraud.

Protections also exist for the employer, although (or perhaps because of the statutory protections) frivolous suits are rare. An experienced qui tam lawyer will only take the case if he or she thinks it can be won (i.e. there exists a substantial body of evidence), and cases can only be brought if they present new information. For instance, if facts are disclosed in the news, by a court proceeding, or other investigation, the case will be dismissed.

This past year, the Supreme Court narrowed the law even further, by holding that Freedom of Information Act ("FOIA") responses issued by a federal agency were considered "reports," and thus subject to the public disclosure bar in the False Claims Act.[4] This unfortunately will bar countless cases where a federal agency may technically possess records that help substantiate a fraud claim, but, absent the whistleblower's FOIA request, bureaucratic inertia would allow the fraud to continue unchecked.

Furthermore, if a whistleblower brings an action that is later found to be frivolous, vexatious, or harassing, the whistleblower may be forced to pay all of the defendant's attorney fees and expenses.[5] Finally, the government has continued oversight over all qui tam actions. Under the False Claims Act, the government may file a motion to dismiss an action regardless of whether the government declined to intervene in the matter.[6] If fraud is found, but the court determines that the whistleblower "planned or initiated the violation," it can deny the whistleblower a share of the reward.[7]

## Need for Qui Tam/False Claims Laws, Constitutional Protections

Government employees are necessarily limited in their First Amendment freedoms.[8] In the context of whistleblowers, specific statutes protect employees who raise the alarm on unlawful or inappropriate conduct. However, when the conduct does not fall under that ambit, the courts do not extend constitutional protections to statements made by government employees in the course of employment.[9]

In *Garcetti v. Ceballos*, the United States Supreme Court considered whether First Amendment protections apply to government employees who speak out against their employers. The court sought to balance the competing interests of citizens commenting on matters of public concern and government employers providing public services.[10] The majority recognized that a government entity has "broader discretion to restrict speech when it acts in its role as employer, but the restrictions it imposes must be directed at speech that has some potential to affect the entity's operations."[11]

Thus, a government employee is protected when speaking on matters of public concern, but can be restricted when doing so is necessary to ensure the effective and efficient operations of government services for which the individual is employed.[12] Rather than silencing employees who become aware of fraudulent activity, especially those who are in the invaluable position of revealing fraud that would otherwise remain secret, legislation was passed to incentivize and protect whistleblowers. Currently lacking, however, is protection for individuals who raise the alarm against private sector fraud that does not impact the public purse.

## New York State False Claims Act

In 2005, Congress passed the Deficit Reduction Act, which decreased the federal medical assistance percentage by ten percentage points (thus giving the state a greater share) for recoveries from actions brought under the act.[13] This law encouraged states to adopt statutes similar to the federal False Claims Act, in order to stop an epidemic of fraudulent activity that often involved Medicaid. To receive the increased recovery rate, a state was required to enact a law with provisions at least as effective as 31 U.S.C. §§ 3730-3732 in rewarding and facilitating qui tam actions for fraudulent or false claims.[14]

The federal incentive came at a perfect time. New York State was plagued by soaring real property taxes, and much of the increase was attributable to skyrocketing Medicaid costs. In addition, a *New York Times* investigative series[15] entitled "Program Disorder" published July 18-19, 2005 found that Medicaid fraud likely added $1 billion or more to the cost of the Medicaid program. That triggered legislative hearings as government scrambled to respond. A perfect storm was building, but in Albany the storm took almost two years to hit. Prodded by the *Times* stories, incentivized by Congress, and urged on by a popular new Governor, Eliot Spitzer, the New York State legislature enacted its False Claims Act[16] ("NYFCA") (Chapter 58 of 2007) to receive the increased recovery awards and begin a concerted effort to combat rampant Medicaid fraud.

The NYFCA was not limited to Medicaid fraud, however; it allowed whistleblower suits whenever the government (state or local) was defrauded by any supplier of goods or services. A highway contractor who used inferior asphalt, a builder who padded costs on a school construction project, or a consultant who billed for hours not worked, were all fair game.[17]

The whistleblower was required to first offer the claim to the Attorney General,[18] who had the right to take the case and prosecute the state's claim. Importantly, a whistleblower could proceed with a qui tam suit even if the Attorney General declined to take on the matter.[19]

The NYFCA was significantly broadened and expanded in 2010 by then State Senator, and current Attorney General, Eric Schneiderman. First, Schneiderman's "Fraud Enforcement and Recovery Act"[20] expanded whistleblower laws to protect former employees, contractors, or agents of an employer, in addition to current employees, from being harmed or penalized by an employer or prospective employer in relation to disclosing false claims. Such protection includes employees who violate their contract or duty to their employer by obtaining or transmitting documents, data, correspondence, email or other information pertaining to the state, local government, a qui tam plaintiff, or private counsel.

Second, the act increased the scope of the NYFCA by allowing a qui tam plaintiff to obtain a person's claims, records or statements for suspected tax fraud, if the damages in the action exceed $350,000 and if the net income or sales of the person being sued is greater than or equal to $1 million for any taxable year. However, before the qui tam plaintiff can make a motion to compel the Department of Taxation and Finance to disclose the tax records, the qui tam plaintiff must first obtain approval from the Attorney General.

*"In the era of Bernie Madoff, where one fraudster looted billions of dollars from investors, or when the British Petroleum well disaster on its DeepWater Horizon drilling rig in the Gulf Coast caused billions in environmental damage, it is certainly appropriate for the Legislature to consider even more expansive whistleblower protections.*

Third, the act increased the time period for commencing a false claims civil action to ten years. Previously, a false claims civil action needed to be filed within six years of the violation or three years after the date when facts are known about the false claim (but in no event more than ten years after the violation). Fourth, the act allowed a qui tam plaintiff to bring a false claims action without stating the specific circumstances constituting the alleged wrongdoing, if the facts proven true in the complaint would provide a reasonable indication that a false claim violation occurred.[21] Finally, the act narrowed the scope of the public disclosure bar under the NYFCA to prevent public information requests from being barred under a false claims action—thus avoiding the *Schindler Elevator Corp*. problem that limits the federal FCA.[22]

## NYC Whistleblower Statute

The New York City whistleblower statute[23] was enacted in 2005 to encourage reporting when any individual, corporation, organization or legal entity commits fraud against the City. It was amended in 2007 because the earlier law did not offer enough protection for whistleblowers. Now, whistleblowers who file suit on behalf of the government can earn up to 30% of any settlement for reporting the fraud. This law focuses on fraud committed by contractors working for the City.

This article has not yet explored a separate body of statutes and case law that addresses whistleblowers who disclose violations of law or regulations which create a substantial and specific danger to public health and safety. State law protects this class of whistleblowers from retaliatory action by their employers,[24] but plaintiffs who assert this claim are barred from asserting any other claims arising out of the events for which the whistleblower protection is asserted.[25] The only exception to the compulsory waiver is for constitutional claims (but see limitations above).[26]

There are regular efforts to expand the types of violations covered, such as legislation recently advanced in Albany. One bill, A.2139 (Benedetto)/S.1517 (Klein) would amend section 740 of the Labor Law to protect whistleblowers against retaliation for disclosing abuse of authority, mismanagement or waste of public assets or monies, threats to the environment, insurance fraud, or financial fraud. If enacted, it would protect a far broader range of whistleblowers, albeit without allowing them to share in any recovery as permitted under a FCA.

Alternatively, A.6971 (Wright)/ S.5620 (Savino) would expand whistleblower protections even further by protecting all whistleblowers who disclose any "illegal business activity." The proposed legislation defines "illegal business activity" as "any practice, procedure, action or failure to act by an employer…or agent of such employer, taken in the course of the employer's business, whether or not within the scope of employment or agency, which is in violation of any law, rule or regulation." Presumably such a measure would protect a whistleblower who disclosed that a bank was "robosigning" mortgage foreclosures, a food worker who revealed that scales were rigged, or an employee of a waste hauling firm who discloses that toxins are being illegally dumped in a landfill. The legislation is so broadly drafted that individuals who disclose virtually any illegal acts would be protected.

Bills of this nature represent the next horizon in whistleblower protection. They go far beyond safeguarding the state's public monies, and are aimed more broadly at protecting the public at large. In the era of Bernie Madoff, where one fraudster looted billions of dollars from investors, or when the British Petroleum well disaster on its DeepWater Horizon drilling rig in the Gulf Coast caused billions in environmental damage,[27] it is certainly appropriate for the Legislature to consider even more expansive whistleblower protections.

## Endnotes

1. 31 U.S.C. §§ 3729-3733.
2. *Id*.
3. The FCA's "first-to-file bar" encourages employees to bring fraud to the attention of the Government as soon as substantial evidence can be gathered. 31 U.S.C. § 3730(b)(5).
4. *Schindler Elevator Corp. v. U.S.*, 131 S. Ct. 1885, 1896 (2011).
5. 31 U.S.C. § 3730(d)(4).
6. 31 U.S.C. § 3730(c)(2)(A).

7. 31 U.S.C. § 3730(d)(3).

8. *Garcetti v. Ceballos*, 547 U.S. 410, 417 (2006); *see Pickering v. Bd. of Educ.*, 391 U.S. 563, 568 (1968); *see also Waters v. Churchill*, 511 U.S. 661, 668 (1994).

9. *Garcetti*, 547 U.S. at 413.

10. *Id*. at 417.

11. *Id*. at 418.

12. *Id*. at 419.

13. 42 U.S.C. § 1396(h).

14. *Id*.

15. *See* Clifford J. Levy & Michael Luo, *New York Medicaid Fraud May Reach into Billions*, N.Y. Times, July 18, 2005, at A1; Clifford J. Levy & Michael Luo, *As Medicaid Balloons, Watchdog Force Shrinks*, N.Y. Times, July 19, 2005.

16. N.Y. State Finance Law §§ 187-194.

17. N.Y. State Fin. Law § 189.

18. § 190.

19. § 190(2)(f).

20. 2010 N.Y. Laws Ch. 379.

21. CPLR 3016(b) requires that a civil action for fraud shall describe the "circumstances constituting the wrong…in detail." This requirement is waived by the 2010 amendments to the NYFCA.

22. *See Schindler Elevator Corp.*, 131 S. Ct. at 1896.

23. 2005 N.Y.C. Local Law No. 630, N.Y.C. Admin. Code § 12-113.

24. Retaliatory action includes "discharge, suspension or demotion of any employee, or other adverse employment action taken against an employee in the terms and conditions of employment." N.Y. Labor Law § 740. *See also Rodgers v. Lenox Hill Hosp.*, 211 A.D.2d 248, 251, 626 N.Y.S.2d 137 (1st Dept't 1995).

25. N.Y. Labor Law § 740(7).

26. *Fischer v. Homes for the Homeless, Inc.*, 1994 WL 319166 *2-3 (S.D.N.Y. 1994).

27. David Barstow, David Rhode & Stephanie Saul, *Deepwater Horizon's Final Hours*, N.Y. Times, Dec. 25, 2010, *available at* <http://www.nytimes.com/2010/12/26/us/26spill.html>.

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# The Joint Pursuit of Government Integrity and High Performance

By Frank Anechiarico and Dennis C. Smith

## Introduction

Frank Anechiarico

Fifteen years ago, Jacobs and Anechiarico concluded their critique of corruption control by suggesting that "[a]n informed discourse on the relationship between public administration and the anticorruption project will help us fit the controls to the task, rather than the other way around."[1] This article is intended as an extension of that discourse.

*"[T]he way in which integrity controls can be formed to fit the work of public administration…is by uniting corruption control with performance management."*

That critique, the core of a book, *The Pursuit of Absolute Integrity: How Corruption Control Makes Government Ineffective*, was framed as a historical narrative of anticorruption reform from the Progressive Era to the 1990s. The exigency of scandal, the momentum of administrative growth, and bureaucratic dysfunction had combined, it was argued, to increase the number and stringency of integrity controls at the expense of agency performance. A further point was that, in several areas receiving especial attention from anticorruption reformers in New York City—building inspection and policing—it was evident that the integrity control regime had not broken the cycle of corruption scandal. This last contention invites re-examination of the cost-benefit ratio related to corruption control, especially given the celebrated administrative and operational reforms undergone by the New York Police Department (NYPD) since 1994.[2]

How the NYPD's CompStat management system influences the level of integrity at the precinct level will be taken up here. However, rather than reconsider Jacobs and Anechiarico's critique point by point, we will take up where they leave off; that is, by considering the way in which integrity controls can be formed to fit the work of public administration, which, we contend, is by uniting corruption control with performance management. In order to make the case for performance management, this article will explore, both intellectually and operationally, the tradition in American public administration of separating integrity issues and performance issues.

## The Divide Between Integrity and Effectiveness

Dennis C. Smith

The controls were so lax that auditors were able to secure their own $2,000 relief check by using ''falsified identities, bogus addresses and fabricated disaster stories,'' and then simply waiting for the money to arrive in the mail, says the report for the Senate Homeland Security and Governmental Affairs Committee, a copy of which was obtained by the *New York Times*.

Nicol Andrews, a FEMA spokeswoman, said the agency recognized there could be fraud. But Ms. Andrews said the priority was getting aid as fast as possible to hundreds of thousands of families in dire need [after the havoc wreaked by hurricane Katrina on the Gulf Coast]. ''We took a calculated risk in a catastrophic situation,'' she said. ''It was the right thing to do. Unfortunately, some may have cheated the system.''[3]

The aid and assistance programs run by the New York City Department of Homeless Services (DHS) also provide emergency payments. However, the DHS payment system is integrated with the federal social security computer system. Whenever a fraudulent number is submitted or a payment is about to be made to someone listed as a long-term resident of Nevada or as no longer living, a bell goes off, literally. The case-worker stops the payment process and notifies the fraud division, which conducts an investigation.

The same social security computer system was also available to FEMA in its response to Katrina and was just as necessary to the integrity of emergency payments as it is to the New York City Department of Homeless Services. However, the social security data were not integrated with the FEMA computer system and, as discovered by the *New York Times* and government investigators, as much a $1 billion was procured fraudulently. The most interesting thing in the statement by Ms. Andrews of FEMA is that the process used by FEMA on the Gulf Coast, as she put it, "was the right thing to do."[4] This is a classic example of dividing performance from integrity. Andrews' use of the value term "right" implies that effectiveness in terms of emergency relief was FEMA's sole concern—and required a neglect of integrity. Though the means exist to bring integrity and effectiveness together in a situation like post-disaster relief, they were not used, so that performance, in this sense defined as distinct from simple output, is clearly degraded.[5] The contrast between FEMA and NYC DHS indicates aspects of performance measurement and performance management that can be used successfully to ensure integrity—and to respond to the Jacobs and Anechiarico critique.

### Skepticism About Performance Measures

The use of careful and well-chosen measurement by managers, then, is a way of avoiding corruption *and* ineptitude, and avoiding corruption and ineptitude is vital to ensuring an optimal level of performance. In the case of the FEMA emergency payments, measures may be read to include matches of the person applying for aid with the area of displacement: that is, matching need with aid. As direct and useful as this palliative may seem, there are many misgivings about what is called the performance measurement movement in administering public programs.[6] We will note at the outset that we do not argue that it is easy or even possible in all cases to find the correct policy outcome (e.g. providing funds to the most needy in a disaster without a high incidence of fraud) or that one system of measurement may be used in all cases. Nonetheless, operating with any single-sided measure of a multifaceted desired outcome almost assures the neglect of the dimension of performance not measured.

As pointed out by several scholars, the hubris of contemporary public administration has been to think that it is capable of applying professional services to most any problem "correctly" and thereby solving it.[7] However, if we consider, as Aaron Wildavsky has, the pervasive problem of dealing with health care in the United States, the outcome has been, without much discussion, defined as access to services: being able to see an internist or specialist, getting pre- and post-natal care, and treatment for disease.[8] If some jurisdictions have succeeded in defining the outcome of police services as not just access to an officer (i.e. rapid response), but, more broadly, as increased public safety, it should be possible to recognize that "health" is more than access, but is, ultimately, physical and mental well-being.[9] Current measures do not consider health care in such a broad fashion. However, it was not long ago that police chiefs would scoff at the thought that they might be held responsible for the crime rate, as most are now. James Q. Wilson and George Kelling's widely read 1982 article, "Broken Windows," is credited with focusing police on "lifestyle"/order maintenance crimes. However, in the course of making their argument, Wilson and Kelling press to move the police away from a focus on direct crime reduction as a measure of their performance.

But the most important requirement is to think that to maintain order in precarious situations is a vital job.… We may have encouraged them [the police] to suppose however, on the basis of our oft-repeated concerns about serious, violent crime, that they will be judged exclusively on their capacity as crime fighters.[10]

In fact, in earlier work, Wilson went even farther, declaring that since the police had no known technology for reducing crime, holding them accountable for public safety rather than for responding to reported crime was overly demanding.[11]

### The Integrity "Half"

The separation (intellectual and organizational) of concern for government performance, including the definition of outcomes and designation of effectiveness measures, from the concern for honest government has neglected their interdependence and diminished efforts to attain either. If we turn our gaze to the anticorruption "project" we discover its flaws and also the degree to which those interested in public performance have ignored it.[12]

### The LAPD, Bureaucracy, and Corruption Control

As Jacobs and Anechiarico explain, the anticorruption project— bureaucratic inspection and oversight— falls prey to the same pathologies that bedevil many bureaucratic efforts: delay, overlap, over-centralization, demoralization of middle management, criminalization of inter-organizational exchange, and goal displacement. A stark example of a modern, professional public agency that defined effectiveness without regard for integrity and vice-versa is the Los Angeles Police Department. We will use it to illustrate what happens when effectiveness and integrity are separated, consciously or unconsciously.

The Los Angeles Police Department was once known and celebrated as the epitome of the bureaucratic style of policing.[13] In the 1950s and 1960s, the LAPD was paramilitary in organization, measured its effectiveness in terms of professional appearance, military bearing and arrests (inputs and outputs, rather than outcomes), and relied on the "appearance of propriety," compliance with written rules and regulations as evidence of the agency's maintenance of standards of integrity. When the word "professional" was used in the Department up through the early 1960s, it denoted expertise in the deployment of personnel and the detection (think "Dragnet"), but not prevention or reduction of crime. It became famous in law enforcement circles and in the public imagination for its efficiency and dedication to its definition of duty—again, defined by officers deployed (input) and number of arrests (output).

### Wages of Conventional Wisdom: From "Dragnet" to "LA Confidential"

The City of Los Angeles changed, but the Department did not. As the Blood and Crip gangs held sway and grew regionally and then nationally, LAPD responded with "strategic intervention."[14] Strategic intervention did not seek to detect or disrupt the causes or patterns of criminality, but to respond in force to reported ongoing incidents.

Virtually the only time that Angelenos saw the police in action was when a number of squad cars swept into an area during or just after a drive-by shooting or incident of drug related violence. The possibility of connecting citizen demand for public safety and police capacity for maintaining it grew more remote by the year.[15] Co-production of the key outcome of police service, public safety, was prevented by racial tension, perceived and real police brutality, and a bureaucratic structure that did not regard public trust as a necessary factor.[16] The LAPD became a classic example of most bureaucratic pathologies. It was characterized by expert professionalism, hierarchy, integrity based on rule compliance, and performance measured by inputs, activities and outputs. Departmental leaders like Daryl Gates pushed the model to its limits and emphasized outputs to such an extent that even rule compliance began to fade, as integrity became an obstacle in what became a war between the police and criminals in areas like Compton and South Central.[17]

In a collection of classic writings about integrity in public administration, William Heffernan makes the critically insightful observation that a democratic society cannot sustain effective service (policing) in the absence of public (police) agency integrity.

> [E]ffective law enforcement in a democratic society is possible only when the police honor basic standards of integrity. Our Constitution has created a series of checks on police power via the Fourth and Fifth Amendments, but these provide the courts with opportunities to control the police only when an arrest is made.… Historically though, there has been a pattern of new officers "bending" under pressures placed on them by more experienced personnel who have already established questionable practices of their own.[18]

Los Angeles had the great misfortunate of proving Heffernan's point. Randall Sullivan's description of the complete ethical collapse of a significant part of the Los Angeles Police Department in the late 1990s indicates a police agency that had rigorously disregarded ethics in order to protect itself from charges, later substantiated, of infiltration by gangs (the Bloods, in particular) and a by a band of thugs connected to the Death Row music company.[19] It is apparent from crime rates collected in the FBI's Uniform Crime Reports as analyzed by the Justice Department's Bureau of Crime Statistics, that after a period of decline, crime sharply increased as the police practices now widely known as the Ramparts Scandal consumed the Department. Violent crimes reported by the LAPD to the FBI dropped from over eighty-eight thousand in 1992 to around forty-six thousand in 1999. In the following three years, the peak of the scandal and the beginning of public awareness about its extent, at a time when crime was declining in most American cities, the rate jumped nearly ten percent. After the reorganization of the Department and the trials of police officers involved, the rate dropped ten percent, just as rapidly as it had risen.[20]

Clear outlines emerge from the Ramparts Scandal and in the history of scandal in various public agencies in New York City and Chicago that make it difficult to dismiss Heffernan's argument. The profile of the scandal-ridden LAPD evolved from a political culture built around reforms that were based on the goal of professionalization as defined in the Progressive agenda at the beginning of the century. These were laudable goals that spawned administrative pathology.

## Contended Ideals and an Innovation

What are the assumptions about ethics and official integrity that informed the reforms that the Progressives prescribed and implemented? Were the Progressives expressing widely shared (modal) beliefs about the distribution of power that had become part of American culture? Does the answer to this question help explain the durability of progressive reform, despite the challenges, and/or negative consequences of the reform agenda? Such shifts are defined and explained by Anthony Amsterdam and Jerome Bruner in *Minding the Law*.[21]

Amsterdam and Bruner take up the question of political culture and how we learn and transmit our beliefs about governance:

> [C]ultures in their very nature are marked by contests for control over conceptions of reality. In any culture, there are both canonical versions of how things really are and should be and countervailing visions about what is alternatively possible… Canonicity and the ordinary are typically in conflict with imagination.[22]

A lack of cultural consensus about a primary regime characteristic like corruption control will lead to certain, predicable, organizational characteristics and syndromes. The first casualty of contended political culture, according to Adams and Balfour,[23] Brint,[24] and Amsterdam and Bruner, is the reliance on value-based ethics in a professional civil service. As the professions became a vehicle for socio-economic mobility, the value base of the professions changed to compliance (rule)-based ethics. Importantly, value-based ethics remains an important aspiration for many scholars and practitioners. This part of political culture is still very much in contention.

The most salient point made by Amsterdam and Bruner for our purposes is that there has been and is currently little cohesion or "canonicity" in the transmission of beliefs about the exercise and control of power. That is, the idea of administrative culture, since the beginning of progressive reform, has been contended ground. The progressive faith in professions and leadership selection as routes to clean, effective government were built on the beliefs and biases of the nascent middle-class at the turn of the 20th century.

By contrast, innovations have been and are being developed that connect integrity, performance and other elements of governance in a way that recognizes the pitfalls associated with the post-Progressive/bureaucratic era of public administration.

## Recasting Integrity

The propensity to separately treat government performance and official integrity has been well documented in the United States and is increasingly clear in other developed nations and in the developing world.[25] As noted above, the cost to the public in this wide variety of polities has been lower levels in both categories: services that are either neglected or are delivered with no measure of their outcome and officials that become dispirited by the "panoptic" series of rules that turn them into "probationers" in the eyes of corruption controllers.[26] The separation and "competition" between effectiveness and integrity thus results in a downward spiral. The decline in public service results in vulnerability to extortion and bribery that further degrades public service. More rules follow each scandal, which hamstring the most dedicated public servants. At least that was the case through the early 1990s in most American cities and other governments in the United States of any size.[27]

The separation causes a crisis in public administration that continues into the second decade of the 21st century. However, we are now in a position to observe instances where integrity and effectiveness are recognized as partners in improving public service performance. The partnership of effectiveness and integrity is an overlooked aspect of, for instance, the role of the New York Police Department in reducing crime to historic lows; the turnaround of chronic misconduct in the City's construction inspectorate, and the successful anticorruption drives in Amsterdam and Hong Kong.

As the building blocks of government legitimacy, effectiveness and integrity must be a primary concern of public officials, commentators and citizens. The waste-bin of comparative politics is full of examples of governance systems that became failed states by neglecting one or both of these elements.[28] What was known as the Eastern Bloc failed, when the compact between citizens and officials crumbled, when corruption became blatant and services were delivered sporadically and preferentially.[29] This is not an exclusive foible of communist systems. We find the same failure in Central Africa, the Caribbean, and South Asia.[30] Though less extreme, we find it in New York City from the 1970s through around 1992.[31] We find it in Detroit during much the same period and in Los Angeles as well. Cynicism, a decline in official engagement with civil society, and an individuation of regard turns the "commons" of governance into a public bad.[32]

Understanding what happened in the agencies and programs that have managed to bring effectiveness and integrity together should give us a way to avoid breakdowns in legitimacy. However, understanding the nature of the elements we are uniting must precede the union. Students of official corruption and public ethics have debated definitions for years, even as the practice of corruption changed around them.[33] Those in and out of the public sector who are interested in government performance have contended with a vogue for business models, privatization, "contracting-out": basically, "the new public management."[34] We find much of the writing done in these two, separate areas carefully researched and useful. The problem, of course, is that they are two separate areas.

We propose broad definitions of integrity and effectiveness that will indicate the connection between them, as Heffernan asserted. There has been recently a movement away from "rule (or compliance)-based integrity" (in which deterrence and detection make the integrity system an arm of law enforcement) toward "values based integrity" that relies on careful recruitment, training, and nurturance of proper workplace ethics. As mentioned, the former has been tried and found wanting.[35] The latter is very attractive, but lacks a validated method, and has only periodic endorsement in the annals of American and most other administrative traditions.[36]

To introduce the fusion between honesty and effectiveness, we draw on the broad definition of integrity that is often used by engineers.[37] A tunnel, bridge or other edifice has "integrity" if, in a measurable way, it can be shown that the design, materials, and building techniques have produced a structure that will perform its functions safely, efficiently, and over the desired period of time. Another way of putting it is that the elements that go into the structure—design, material, and technique— have been well integrated to produce an effective result. Corruption, in the same metaphor, is the disintegration of critical elements. If unchecked, disintegration results in failure of the structure. The integrity of a structure, physical or organizational, thus is defined by the quality of its continued performance. The Brooklyn Bridge has performed perfectly for over 120 years, the result of a brilliant design, the best materials available, and use of innovative building techniques. The New York Police Department was redesigned in the 1990s.[38] New materials in the form of computer-aided crime and corruption statistics analysis by precinct were employed, and techniques used in personnel deployment and evaluation were completely reformed.[39]

Reflecting the bifurcation of focus on effectiveness and integrity that characterizes public administration, most observers are aware that crime has come down by more than two thirds in New York City from 1996 to 2006—the downward trend continued to 2009[40]—and that decline strongly correlated to the institution of a management reform called CompStat.[41] But little attention[42] has been given to the fact that corruption complaints, after the introduction of a performance management approach, have declined by the same proportion during that period.[43] The result was a new integration of effectiveness and honesty that could be measured by street-level performance and resulting public safety improvement.[44] In a system that depends on measurement to ensure performance integrity, indicators of "corruption" appear in the routines used to gauge efficient outcomes; e.g., assessing a bridge's load capacity and measuring crime and corruption rates.

While there has been little research on the conjunction of integrity and effectiveness in the public sector, there are a few works that broach the issue. Though not at the center of the movement, several progressive reformers—especially Robert DeForest and Lawrence Villers in New York City[45]—designed their agencies with both effectiveness and integrity in mind. The Public Choice movement and the work of Vincent Ostrom are directly relevant in their concern for measurement and citizen assessment.[46] We also find a basis for rethinking the separation of integrity and effectiveness in organization theory. James Thompson's classic, *Organizations in Action*, makes synthetic and contingent thinking about organizational goals and values seem inevitable.[47] Further, the perspective of the engineering profession on the idea of integrity will be revisited below.

## Integrity and Effectiveness in Action, Together

The cases described here illustrate diversity in the way that polities and individual agencies have brought the pursuits of effectiveness and integrity together in the administrative process.

## The Netherlands: Training and Compliance

Up until the late 1980s the Netherlands, like the Scandinavian countries, considered itself nearly free of official corruption. Not that there was a complete absence of official misconduct. Years after the United States prohibited bribery of foreign official by American business with the Foreign Corrupt Practices Act (1977),[48] the Netherlands continued to make such payments tax deductible. (The OECD and then the EU prohibited such bribes in the 1990s.)[49]

However, a book, the Dutch title of which translates as *The Republic of Friends*, written by journalist Joep Dohmen, detailed kickback schemes and evidence of organized crime in the South of the country.[50] The book led to a flurry of investigations and a set of anticorruption priorities established by the Minister of Justice, Ms. Ien Dales.[51] A conference held in the Hague with officials from the New York State Organized Crime Task Force indicated that the Dutch were engaged in serious self-examination, but were unwilling to adopt the Americans' recommendations of wiretapping, undercover operations, and punishment of racketeers with long prison terms.[52]

Instead, there was a period of soul searching on the National Audit Court, in the Ministries of Justice and the Interior, and in the police establishment about the need for integrity values training versus a more aggressive anticorruption (read: American-style) strategy. In the end, the Dutch pursued both.

Perhaps the best example begins with the discovery in the late 1990s of longstanding kickback schemes and bid-rigging in the decades-long building of new train tunnels under Amsterdam: one North to South and one East to West.[53] There followed the arrests of a number of officials and contractors and the creation of the Amsterdam Integrity Bureau.[54] In dealing with the kick-backs and bid-rigging, the Dutch seemed to change their minds about the American model, by consulting one of the principals of the New York State Organized Crime Force, who had since become a security analyst, Thomas D. Thacher.[55] Thacher helped law enforcement officials use several of the techniques earlier rejected to apprehend the key figures in the tunnel-building scandals.[56] In this way, the Dutch established compliance regimes in the inspection of construction and in the procurement process that would assess performance (past and present) and include the element of "responsibility" in the bidding process.[57]

At the same time, the new Integrity Bureau was hard at work training and retraining public officials in Amsterdam and elsewhere about situations they were likely to confront, especially with major construction projects ongoing and planned around the country. Contracted university and consulting firm KPMG's ethicists conducted all-day seminars for groups of officials. These sessions would present participants with a series of ethical issues likely to arise in the course of their duties. No specific "answer" is given in these sessions, but each participant is expected to speak and write at length about the nuances of the problem and the choices confronting him or her in responding to the scenario. Trainees comment on each other's responses and, if it goes as planned, leave the session with a heightened sense of integrity and ethical responsibility—or, at least a sense of the importance placed on these values by local and national government.[58]

The idea that integrity and effectiveness are conjoined is not explicitly stated by public officials in the Netherlands, but is very much part of discourse among academics and consultants. The Integrity Working Group in the Department of Public Administration, led by Prof. L.W.J.C. Huberts at Free University in Amsterdam, has published a number of papers that indicate a definition of integrity that necessarily encompasses a high level of performance.[59] The group's working premise, as explained by Prof. Huberts, is that those interested in democratic governance must see integrity in a broader light to avoid a trade-off between honesty and effectiveness.[60] The practical point, and the Dutch find such arguments very appealing, is that time and money is wasted by corrupt practices, so integrity is a necessary part of efficient, effective performance. Because of the unusually close working relation between academics and public officials in the Netherlands, constructs developed by the Working Group find their way into public policy.[61]

## Hong Kong: A Complete Package

The remarkable success of the Hong Kong Independent Commission Against Corruption (ICAC) dates from the late 1960s and its founding in the wake of a police scandal under British colonial rule. The ICAC was given extraordinary power in three areas: law enforcement, education, and prevention.[62] The ICAC is generally credited with transforming what had been considered one of the most corrupt polities in a region where there is a great deal of corruption, to an efficient and honest place to do business.[63] That fact alone seems to connect integrity and effectiveness, in this case, not only in the official sector, but also of the entire political economy, which had been dominated by organized crime and ties to traditional family syndicates.

The story of Hong Kong is perhaps the clearest demonstration of the progress that can be made in service to the public (government performance) by paying careful attention to integrity. While it has been noted, and must be again, that the ICAC has a high degree of authority when compared to most anticorruption regimes in democratic nations—it can enter the homes of civil servants without warrants to determine whether they are living above their means—it must also be noted that the ICAC has an extraordinary focus on education and prevention and devotes considerable resources to each.[64]

In addition to drop-in centers and a television program that features (and celebrates) their service to the public, the ICAC visits schools, the way some U.S police departments deploy "officer friendly," and advises businesses on the ethical perils of global commerce. In these efforts, the ICAC works closely with the Hong Kong Police. When the ICAC was established, roughly sixty percent of corruption complaints (n=approx. 3000) came through official channels.[65] Now, because of the close cooperation of the police and the ICAC, nearly sixty percent of corruption complaints come from the public, which, according to surveys, has very widely accepted the ideal of high level service from public agencies that are also reinforcing the reputation Hong Kong as an honest place.[66]

Hong Kong, like New York, was long infamous for public corruption. However, reforms made during the last generation of British control have allowed the government of what is now the Hong Kong Special Administrative Region of China to fuse effectiveness and integrity. The economic boom in Hong Kong over the past twenty years is often attributed to these reforms.

## New York City: From the Tweed Ring to Integrated Measurement

The treasury of the city of New York hemorrhaged money for generations due to well-organized, publicly tolerated graft and corruption. Reference may be made to the exploits of the corrupt syndicate headed by New York State Senator William Meager Tweed. In the last quarter of the nineteenth century, the Tweed Ring raked in what in today's terms would be hundreds of millions of dollars in kickbacks, inside dealing in land purchases, extortion, and bribery.[67] Tweed died shortly after being extradited from Spain and there followed an orgy of anticorruption legislation and integrity institution building.[68] Reformers bolstered the authority of key agencies: the Commissioner of Accounts (now the Department of Investigation), the independently elected District Attorneys of all five boroughs of the city, and the independently elected City Comptroller.[69]

As noted above, the remarkable emphasis on compliance and rule-oriented control of corruption grew to the point that it began to stifle the delivery of services by the line-agencies of municipal government. While review of the effect on the speed, and efficiency of procurement rules particularly, began in the mid-1990s with the mayoralty of David Dinkins, the idea that integrity could not, and should not, be separated from procurement effectiveness dates from the first years of the administration of Mayor Michael Bloomberg in 2002.[70] The initial part of the shift is the widely acknowledged success of the performance measurement and management system mentioned above, CompStat (computer statistics), in the New York Police Department.

CompStat used computers deployed at the district level to analyze the same crime reports used at police headquarters to map daily the crime trends in small areas of the city.[71] The district commander was held personally responsible for deploying resources to deal with the patterns found in the analysis of data.[72] Importantly, the commander was also answerable for any corruption or misconduct in his or her precinct.[73] This alignment of authority, along with the anonymous 311 call-line installed to deal with service complaints, holds precinct captains responsible for integrity, as well as the crime rate.[74] CompStat is not without its detractors—it is not community policing—but it is most often given credit for the enormous decrease in crime in New York City since the mid-1990s, so that New York City's crime rates now approach crime levels last seen in the 1960s.[75] New York became the safest large city in the United States.[76]

The CompStat model eventually caught on with the support, first of Mayor Giuliani and then with Mayor Bloomberg and his Office of Operations.[77] All agencies are now required, for the annual Mayor's Management Report, to designate outcome goals and measures used to assess progress toward meeting them.[78] In each case, integrity is part of the program. As mentioned in the FEMA example above, agencies providing housing support or education understand that integrity violations or breakdowns will jeopardize their ability to reach established goals. The trick is to link measures of integrity to measures of service effectiveness.

For example, the New York City Department of Buildings has, since its founding and until very recently, been a center of corruption.[79] The ability of a modestly paid building construction inspector to stop work on a project or order costly changes to bring the project into compliance with arcane codes made the inspectors key figures in the cost/benefit calculation of builders. Extortion or bribery was almost natural. "Do I make changes that will slow the project so that my return on investment is postponed, costing tens of thousands of dollars, or do I pay the inspector five hundred or a thousand dollars to sign-off on the project?" As one chain store owner explained to us, he would come to the final inspection meeting, at which the certificate of occupancy was to be issued, with a suitcase full of cash.[80]

The problem was that no one had any way of knowing where the inspectors were or what they were doing. The Bloomberg administration sought help from computer networking specialists who designed a handheld inspection tool that transmitted, in real time, all comments and findings while the inspector was on-site. It also had audio recording capacity. This, together with random double-checks by supervisors, virtually eliminated the parade of arrested inspectors that were led out of headquarters by one law enforcement agency or another on an annual basis.[81] Nonetheless, law enforcement is still in evidence and resulted in the well-publicized arrest of a crane inspector in 2008.[82] It should also be mentioned that by putting the permit approval process online, applicants are no longer so dependent on "expediters" who would stand in line for the permits, obtain them and then, on occasion, lie to the applicants so that they could continue collecting their daily fee. In more than one case, a builder who had hired an expediter called the Department of Buildings to ask why a permit was taking so long to be issued. The builder was referred to the online system, which reported that the permit had been cleared weeks previously. After two or three such reports, this expediter behavior disappeared. The system was streamlined so that clerks working for the builders could file applications and then watch the department's website for approval.

These compliance changes and the added transparency at the Buildings Department have been reinforced by the intensive integrity training that the Department of Investigation conducts in all agencies and does so with special intensity in traditionally corrupt agencies. We have observed the operations of the New York City Department of Buildings for over twenty years. Problems still exist, but change is clear. The combination of performance measurement through the inspection computer system and the measurement of the speed and accuracy of permit issuance, measured by routines built into the online system, together with training and committed leadership have shifted the organizational culture of the department. This is an agency that every mayor since Fiorello LaGuardia in the 1940s has railed against, but which has made progress by embedding integrity in measurement.[83]

## From Case Studies to a Model of Administrative Culture

Shaking off the grip of convention, when it is buttressed by bureaucratic notions of integrity and measures of effectiveness unconnected to result, requires a change in the culture of public administration. The fragmentation of culture noted by Amsterdam and Bruner reminds us that previous reform efforts were often partial and often failed. The goal of this section is to distill the factors from our case studies. These factors return to the concluding recommendation of Jacobs and Anechiaricio's critique and can be read as prescriptions designed to fit corruption controls to the work of public administration, rather than the other way around.

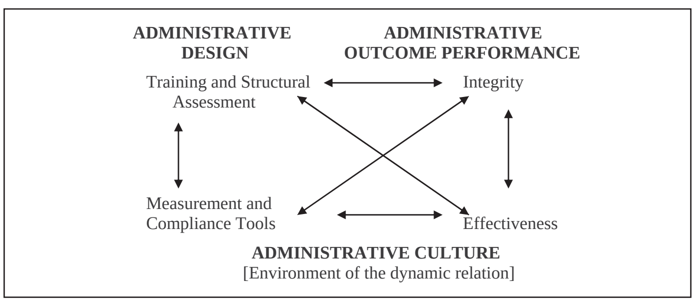
| **Table 1. Elements of the Union of Effectiveness and Integrity in Public Administration** |
|---|
| • *Transparency* of operations and *co-production* of services with citizens: Hong Kong's outreach and education; New York's 311 system; investigatory reporting in the Netherlands. |
| • *Entry-level and in-service training* that emphasizes the waste and ineffectiveness of corruption. This is the place in the process where value development and compliance are brought together. An unacknowledged strength of the "performance review meeting" component of CompStat is that it is a very powerful training tool. It is worth noting that this tool is spreading rapidly. The entire government of the city of Baltimore uses what it calls Citystat. |
| • Use of *outcome measures* to keep agencies oriented toward their missions, which include integrity. The measures are then used to improve the management of service delivery. |
| • Holding *middle-management responsible* for both integrity and effectiveness. Police in all of the jurisdictions in our cases had a clear understanding that patrol commanders could be accountable for crime rates and that making them answerable for any scandal in their purview would very likely be a deterrent for the average patrol officer. |
| • *Technology* used to measure outcomes. All of our cases used rapid collection from field sites to collect data on outcomes: integrity and misconduct complaints, inspectional speed, and code infractions. Central analysis, after determining patterns on a number of dimensions (geographical, by government employee, by client, by manager; e.g., is a particular employee improving outcome, but racking-up integrity complaints?), then quickly feeds the patterns back to administrators for use in management. This factor and the pattern recognition it entails have been very influential in enabling the connection of integrity and effectiveness. |

The model of public administration below is provided by analysis and reconstruction of these factors and is direct enough to be replicable. The obvious caveats about "one size not fitting all" and the difficulty of transplants across cultures are observed, as the model is both elastic and specific. This is possible by describing the application of the model's factor in a variety of settings.

The big question is how a reform such as the one supported here influences governance more generally. The conjoining of effectiveness and integrity supports and strengthens political and cultural legitimacy. It cannot be argued that the conjunction will occur in a broadly corrupt system. We conclude by placing the conjunction of integrity and effectiveness alongside comparable and mutually reinforcing reforms in the history of public administration.

Adapting a structural engineering model that's use correlates to the major concepts employed here will summarize our findings. M. Neil James, an eminent British engineering scholar, developed a simple model that relates the key components of high-integrity physical structures in a way that stimulates the synthesis in Figure 1. Translating (by extension and transposition) the elements of James' model provides a compact description of our argument.[84]

**Figure 1. The Dynamic Relation of Administrative Design and Operation**




## Conclusion

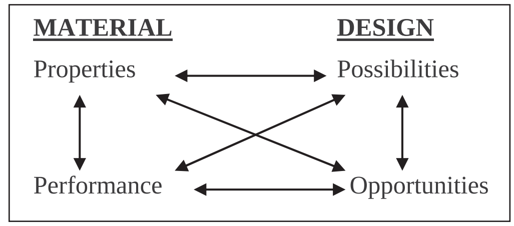
The basic elements in Table 1 and Figure 1 are included in the analytic argument in the first half of this article and in the cases in the second half. None of the elements work to change administrative culture toward high-level, honest performance without all of the others being in place. Training, both entry-level and in-service, are used in New York, Amsterdam, and Hong Kong. In each case, we discovered that what had been a series of threats had been transformed into the analysis of scenarios and the surfacing of ethical and quality measurement problems.

Structural assessment was also done in all three cases. It was especially necessary in New York City, where the integrity system had become counterproductive and obstructive of service delivery. The rules and institutions of a completely compliance-based system had to be reconsidered and redesigned.

The careful choice and deployment of measurement and compliance tools, using appropriate technology, ensures that administrators have the information necessary to ensure honest performance and the means of detecting violations of the design as it is put into operation. The close connection between *integrity and effectiveness* has been asserted and demonstrated. Performance ought to be understood to include integrity and vice-versa.

### Appendix A

**Fig. 1. Inter-Relationships Between Materials and Design[85]**

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# Doing Well by Doing Good: Can Corruption Prevention and Government Efficiency Strategies Help Turn Around Declining Cities?

By David R. Eichenthal

## I. Introduction

In the mid-2000s, the Center for Excellence in Government commissioned a series of surveys of city residents across the U.S. asking questions related to key factors in economic development. One factor was consistently among the most highly rated—effective local government that is free of corruption: other surveys have produced similar results.[1]

Business leaders agree. More than high taxes or burdensome regulation, what businesses fear most from local government is uncertainty. Is the building permit going to take two days or two years…or will it require payment of a $2,000 bribe to obtain?

The relationship between corruption and economic development is frequently written about in the context of the economic revitalization of Third World nations. A World Bank survey in the mid-1990s found "more than 150 high-ranking public officials and top citizens from over 60 developing nations ranked corruption as the biggest impediment to economic development and growth in their countries."[2]

In 2003, the United Nations General Assembly adopted the Convention Against Corruption: at the time, Secretary General Kofi Annan wrote "[c]orruption is a key element in economic underperformance and a major obstacle to poverty alleviation and development."[3]

Yet, there is less of a conversation about the relationship between corruption and economic development in the United States. According to the 2010 Transparency International Global Corruption Index, the U.S. ranks 22nd out of 178 nations in perception of corruption—with a first place ranking denoting the least corrupt.[4] While the United States is no Somalia, Myanmar or Afghanistan—the three nations tied for last in the Index—it does trail global leaders like Denmark, New Zealand and Singapore.

As a nation, the United States remains one of the world's great economic powers and comparisons to underdeveloped or undeveloped nations border on absurdity. But prosperity in the United States is not uniform. Parts of the nation have declined over the decades, losing both jobs and population.

In particular, deindustrialization has left many of the nation's midsize and large cities reeling—jobs left, were not replaced and residents fled. The results are entire neighborhoods of vacant land or vacant buildings, blight, reductions in tax revenue, increasing service needs and an overall downward spiral that is difficult to pull out of.[5]

This article offers the argument that for many of these cities, corruption has been a part of—or accelerated—long-term decline. And just as there is an international consensus that corruption prevention and reduction is critical to development, there should be a local and national consensus in the United States that economic turnaround of these declining cities will require a similar focus on "the basics"—effective local government without corruption.

*"More than high taxes or burdensome regulation, what businesses fear most from local government is uncertainty."*

The article examines three cities—each of which has faced long-term population and economic decline—that are in different stages of recovery and that have pursued different approaches to the issue of corruption—New Orleans, Cleveland and Birmingham. Finally, this article concludes with an examination of corruption prevention and economic development in the nation's largest city, New York, and suggests that the city government's elaborate web of corruption prevention initiatives may have contributed to its revitalization over the last two decades.

## II. A Starting Framework

In order to examine the impact of corruption—or the lack of it—on economic development, it would be helpful to have a means of accurately measuring levels of corruption. Perhaps the best source of public corruption data is the U.S. Justice Department Public Integrity Section, which provides annual data on Justice Department investigations, prosecutions and convictions for public corruption.[6]

Just as arrest and prosecution data is an imperfect measure of other types of crime, it is certainly an imperfect means of measuring corruption—but it may be the best proxy available. Not all acts of public corruption are reported, let alone prosecuted. Federal prosecutors only prosecute a portion of public corruption crimes—local prosecutors may also do so: differences in rates of public corruption convictions by judicial district may be the result of differences in resources or prosecutorial priorities rather than the prevalence of corruption.[7] Some districts may have higher rates of prosecution (i.e. prosecutions per capita) than others because of the concentration of state and federal government officials: for example, high corruption rates in judicial districts that contain state capitols or large federal facilities (e.g. NASA in Houston, the Center for Disease Control in Atlanta). Still, while not dispositive, federal public corruption conviction rates offer a means of cross jurisdictional comparison that is unavailable based on other metrics. For example, there is no jurisdiction-by-jurisdiction reliable survey of perceptions of corruption—either among the public or, like the Transparency International survey, among business leaders.

## III. New Orleans

Scenes from New Orleans' Lower Ninth Ward in the aftermath of Hurricane Katrina were a dramatic symbol of poverty and economic decline. New Orleans' history of economic decline, however, started well before the hurricane that devastated parts of the city in 2005.

Between 1960 and 2005, New Orleans lost more than 172,000 residents, or 27% of its total population.[8] Since 2005 and Hurricane Katrina, New Orleans has lost an additional 111,000 residents.[9] In addition, between 2000 and 2008, the number of businesses located in New Orleans declined from 10,619 to 8,193 and the number of people working in the city was down by close to thirty percent.[10]

Based on data from 2006 to 2009, nearly one in four residents in New Orleans lived in poverty: in 2000, there were sixteen census tracts in the city where more than half of the residents were living in poverty.[11]

Based on the number of public corruption convictions per capita, the federal judicial district that contains New Orleans has the highest rate of public corruption in the nation. Across the state, one could argue that public corruption is near endemic—from the kickback schemes of Governor Huey Long made famous in fiction by Robert Penn Warren's *All the King's Men*—to the conviction of three-term Governor Edwin Edwards.[12]

And public corruption has not been limited to state government. Over the last three years alone, federal prosecutors have won convictions of the one-time Chair of the New Orleans City Council for a kickback scheme involving City parking contracts;[13] the conviction and guilty plea of two out of the last four chief technology officers for the city on kickback and bribery charges related to rigging tens of millions of dollars in city contracts for technology consulting;[14] and the conviction of the one-time chief financial officer of the local housing authority who embezzled nearly $1 million over a three year period.[15] At the same time, eleven current or former members of the New Orleans Police Department have been indicted for their role in the deaths of two unarmed individuals during Hurricane Katrina.[16]

Recent years may signal a shift in the tolerance of corruption in New Orleans at the local level. In New Orleans, the Office of Inspector General was created through a 1996 referendum.[17] The ordinance implementing the law, however, was not enacted until 2006.[18] Inspectors general have a four-year term and may only be removed from office by a two-thirds vote of the Ethics Board. The Office of Inspector General can only be abolished by a two-thirds vote of the City Council. The first Inspector General resigned after just seventeen months, but the newly appointed Inspector General has started to produce a steady flow of oversight reports on city government.[19]

In 2009, the City Council also created an Independent Police Monitor position within the Office of Inspector General to begin to address allegations of abuse and corruption in the New Orleans Police Department.[20]

Perhaps the most dramatic reforms have emanated from the city's new mayor, Mitch Landrieu. In one of his first acts in office, Landrieu—and his Police Chief Ronal Serpas—took the unusual step of asking the federal government to go beyond prosecution of individual officers and conduct a comprehensive review of the department. Both Landrieu and Serpas were blunt—Landrieu noted that the New Orleans Police Department had been described as "one of the worst police departments in the United States."[21]

Even before the Justice Department finished its review, Serpas undertook a series of major departmental reforms—including placing a civilian attorney in charge of the Department's Public Integrity Bureau.[22]

The result of the federal review was a detailed, 115-page report with 148 specific recommendations covering use of force; stops, searches and arrests; discriminatory policing; services for non-English speakers; sexual assault investigations; domestic violence investigations; recruitment; training; supervision; paid details; performance evaluations and promotions; misconduct investigations; community policing; officer assistance and support; interrogations and community oversight.[23]

Mayor Landrieu has dedicated significant new resources to making city government not just less corrupt, but more efficient and effective as well. It is important to recognize that, done the right way, efficiency initiatives can have a direct impact on corruption reduction. Often, acts of corruption are a way around processes that are not working—the bribe to avoid a too-long process to obtain a building permit or kickbacks to gatekeepers in a complicated government procurement system.

In 2007, under the prior mayor, New Orleans began a process of "budgeting for outcomes"—where city resources are allocated on the basis of results and performance rather than incremental increases or reductions. The Landrieu Administration has built upon this effort with renewed resolve: last year, for the first time, the budgeting for outcomes process drove the majority of key budget allocation decisions.[24]

A Landrieu innovation has been the creation of an Office of Performance and Accountability.[25] Reporting to the Chief Administrative Officer and first Deputy Mayor, the mission of OPA is "to promote exemplary performance, accountability, and transparency in the delivery of city services through the timely analysis of performance data." New Orleans has already started a series of "PerformanceStat" initiatives—modeled after the police model of measuring and managing performance through data (CompStat)—with a focus on issues from blight reduction to revenue collection.[26]

It is too soon to tell whether the Landrieu Administration will succeed or fail in its reform efforts. But it is noteworthy that perhaps the one U.S. city best known globally for its economic challenges has turned to efficiency and corruption prevention as key strategies for progress.

## IV. Cleveland

In 1950, Cleveland was the nation's 7th largest city—with a population of 914,808.[27] Through the 1960s, Cleveland was the heart of the nation's steel belt: by 1970, there were still approximately 265,000 jobs in manufacturing in and around Cleveland in Cuyahoga County.[28]

By 2010, Cleveland had lost more than half of its residents—with a 2010 population of less than 400,000.[29] By 2008, there were just 80,000 manufacturing jobs in Cuyahoga County—two-thirds fewer than in 1970.[30] In Cleveland, by 2009, approximately 25,000 residents were working in manufacturing compared to more than 100,000 city residents living in poverty.[31]

By the mid-1970s, economic decline also led to fiscal shortfalls. In 1978, the City of Cleveland defaulted on more than $15 million in short-term notes.[32] To make a bad situation worse, Cleveland was the "canary in the coal mine" for the mortgage foreclosure crisis of the last decade. A 2008 study found more than 12,000 vacant properties in the City of Cleveland—properties that were often blighted, were abandoned by owners and that became a burden for local government.[33] The city of Cleveland sued—thus far unsuccessfully—leading Wall Street banks claiming that the foreclosure crisis had cost the locality more than $35 million in both lost revenue and the cost of services.[34]

The Northern District of Ohio ranked 16th nationally in per capita public corruption convictions in the last decade and 11th in the most recent three-year period. In the last three years, Cuyahoga County attracted unwanted national attention for a massive corruption scandal in county government.

Since 2008, six former or current countywide elected officials have been named in one of the widest ranging corruption scandals in the history of Ohio. They included county judges, one of the county's three-member commission, the county auditor and the county sheriff.[35]

The former county commissioner was indicted in 2010 on a twenty-six county federal indictment alleging that he had traded county jobs and contracts for cash, travel and other kickbacks. In 2011, federal prosecutors re-filed charges against the commissioner—who had also been the chair of the Cuyahoga County Democratic party—under the federal RICO law, alleging that he essentially ran the county government as a criminal syndicate.[36]

The former county auditor pleaded guilty to twenty-one corruption counts and was sentenced to more than twenty years in prison for his role in the bribery and kickback scheme.[37] The former county sheriff forced his employees to sell tickets to his yearly fundraiser, stole money from his campaign fund and appointed his son as a special deputy.[38]

The corruption probe and subsequent indictments and convictions led to fundamental reforms of county government. In 2009, a group of citizens successfully pressed for a shift in county government from the three- member commission to a countywide elected executive with a legislative county council. As a result of the change in government, the sheriff and auditor would no longer be elected officials and instead would be appointed by—and accountable to—the new county executive. The prior position of auditor had performed only minimal actual audit activities. Under the new county government, a Director of Internal Audit was to be appointed by a countywide audit committee selected by both the executive and the county council.[39]

Finally, a citizens transition committee in 2010 recommended the creation of an independent Inspector General.[40] Ed Fitzgerald, a former prosecutor and former FBI agent, campaigned on the proposal of an inspector general and won election as Cuyahoga County's first county executive. In one of his first acts as executive, he appointed an Inspector General under his executive authority to conduct investigations: as this article is being completed, the County Council has passed legislation creating a permanent office of inspector general with a five-year term.[41]

## V. Birmingham

Like Cleveland and New Orleans, depopulation, losses of jobs and corruption have plagued Birmingham, Alabama for a half-century. In 1960, Birmingham had 340,887 residents.[42] The city's population had boomed in the 1950s, with population up by more than 20 percent. Yet, by 2010, Birmingham's population dwindled to just 212,237—a decline of 37.8% from its peak and down by 12 percent in the last decade.[43]

Birmingham was once the "Pittsburgh of the South."[44] Yet, by 2009, fewer than one-in-ten Birmingham residents worked in manufacturing and more than one-in-four Birmingham residents—26 percent—were living in poverty.[45]

Alabama has a history of political corruption. Auburn University historian Wayne Flint has written "ethics laws could make political corruption illegal in Alabama, but could never make it unpopular."[46]

The Birmingham of 1960 was also the Birmingham of Bull Connor—who as Commissioner of Public Safety led the violent effort to block civil rights for African Americans in the city. Conflicts over civil rights embroiled the city and led to divisions within the business community and civic leadership. And the 1963 church bombing that killed four young girls permanently stained the city's reputation across the world.[47]

The Jefferson County sewer crisis is the most recent corruption scandal to touch Birmingham and may lead to the county's bankruptcy. In the 1990s, the federal Environmental Protection Agency and the county entered into a consent decree that called for the county sewer system to invest billions of dollars in capital improvements. The projects were funded through a series of variable interest rate bond offerings and complicated financings.[48]

In 2008, the local U.S. Attorney indicted the former president of the County Commission—and then-mayor of Birmingham—for his role in a bribery scheme involving the financing scheme. In 2009, a jury convicted the mayor on 60 counts of conspiracy, bribery, fraud, money laundering and filing false tax returns. The mayor had used his influence to bring a local firm in on the financing deals that produced more than $7 million in fees for the firm. In return, the mayor received nearly a quarter of a million dollars in payments, gifts and loans from the firm and one of its lobbyists. The former mayor was sentenced to fifteen years in prison.[49]

In 2010, another former member of the Commission was convicted of receiving bribes from a contractor who participated in the projects and another member of the Commission was also convicted for receiving gifts from Blount Parrish in connection with the scheme.[50]

While the investigations and prosecutions have ended, there is a lasting impact for the county. By 2010, Jefferson County had defaulted on payments on the bonds and was seeking protection in bankruptcy. Instead, a state court judge appointed a receiver.[51] As of June 2011, the county has implemented layoffs for more than 500 workers, planned to close court facilities and the sewer system receiver has proposed a 25 percent increase in fees—all to reduce spending to allow for payments on the sewer-related debt.[52]

Unlike New Orleans and Cuyahoga County, Jefferson County has not yet taken steps to promote internal corruption control or efficiency. The county does not have an Inspector General or an Office of Internal Audit.

## VI. Is New York a Model of Corruption Prevention and Economic Recovery?

In the late 1970s, the symbol of urban decay in the United States was the nation's largest city—New York. Between 1970 and 1980, New York lost more than 820,000 residents—a greater than 10 percent decline in population and the equivalent of a city of the size of San Antonio, Texas at the time disappearing.[53] New York in the 1960s and 1970s saw dramatic increases in crime and declines in the city's manufacturing base: between 1969 and 1999, manufacturing employment in New York City declined by 68 percent.[54] New York barely escaped from bankruptcy and one year—1977—brought the city a blackout, looting and a serial killer.[55] Depopulation led to housing abandonment, arson and increased cost to city government, as it became New York's largest landlord.[56]

New York also had a long history of public corruption, dating back to the Tammany Hall era. The city building behind City Hall—affectionately named the Tweed Courthouse, after the one time Tammany leader—serves as a permanent reminder.[57] During a twenty-year construction process beginning in 1861, Tweed embezzled millions from the construction project. In 1873, he was convicted of the crime in an unfinished courtroom in the building and sentenced to twelve years in prison.

In 1970, the Knapp Commission revealed systemic corruption within the New York Police Department. Extortion and bribery had become almost the norm within the ranks of the Police Department—everything from small payments to massive schemes to pay off police officers to look the other way when it came to gambling and drug operations in the city.[58]

The star witness before the Knapp Commission, and the source of the *New York Times* front-page story that fueled the inquiry, was New York Police Department Detective Frank Serpico who testified about the pressures within the department to participate in payoffs and the failure of department officials to respond to his allegations of corruption, allegations that almost cost him his life.[59]

Later, in the mid-1980s, a massive corruption scandal rocked city government. The Parking Violations Bureau scandal involved the ultimate effort to fix parking tickets. Queens Borough President—and County Democratic Party chief—Donald Manes was at the center of a conspiracy to steer a multi-million dollar city contract to a firm that was a front for former Deputy Mayor—and Bronx Democratic party chief—Stanley Friedman. As the scandal unraveled, Manes committed suicide. Over a four-year period, a series of investigations and prosecutions by then-U.S. Attorney Rudolph Giuliani revealed a "city for sale" of dimensions unseen since the days of Tammany.[60]

New York City responded to the fiscal and corruption crises in the 1970s and 1980s. New York was able to escape bankruptcy through a series of strict limits on City spending and borrowing imposed by both the state and as a condition of federal loan guarantees for the city.[61] Through revisions to the City Charter, the city was required to establish multi-year financial planning, regular reporting on the budget and city operations: New York became perhaps the first city to regularly report on local government performance through the twice a year Mayor's Management Report.[62] And contracting power was centralized in the mayor upon the abolition of the city's Board of Estimate.[63]

The New York Police Department, in the early 1990s, invented the CompStat approach to crime fighting—a reform that many cite as a central reason for the historic declines in crime enjoyed by the city over the last twenty years.[64]

Reforms instituted by the Knapp Commission remain in place at the Police Department to this day. While subsequent investigations of the Police Department have found continued instances of corruption and misconduct, there has been nothing of the same endemic and systemic nature as was uncovered by the Knapp Commission forty years ago. A 1994 report on police corruption concluded that, unlike during the Knapp era, "[M]inor corruption is no longer systemic among the ranks."[65]

By 1990, New York City had the most elaborate, well-staffed, well-funded anti-corruption effort in the nation. Virtually every department and agency of city government had an inspector general, reporting to a citywide Department of Investigation.[66] The city's chief auditor, the elected Comptroller, had hundreds of auditors on staff.[67] City contracting was governed by a new and elaborate set of rules promulgated by a Procurement Policy Board.[68] A Conflict of Interest Board oversaw ethics laws.[69] Limits on lobbying were enforced through the City Clerk.[70] In the late 1980s, New York became the largest local government to enact campaign finance reform with strict limits on campaign contributions and provision for public matching funds.[71]

As many of these reforms were being implemented, some suggested that the New York's anti-corruption project and "pursuit of absolute integrity" was ineffective and would only increase government inefficiency and spur new forms of corruption.[72]

Twenty years later that does not seem to be the case. No system of corruption control will ever be perfect. Current scandals involving the near billion-dollar procurement of a new payroll system and alleged ticket fixing in the Police Department certainly recall past corruption.[73]

Still, it is informative—if not dispositive—to return to the measure of corruption discussed earlier, the number of successful public corruption prosecutions. In the 1980s, the United States Attorneys for the Eastern and Southern Districts in New York (the two judicial districts covering New York, as well as surrounding suburbs) averaged 81.7 public corruption convictions per year. A decade later, the average declined to 63.9 and, during the last decade, the average was down to 44.6 per year.[74]

And this apparent decline in corruption occurred as New York became the one great economic turnaround story among America's older cities. After losing ten percent of its population in the 1970s, New York saw a population rebound in the 1980s and a near ten percent gain in population in the 1990s.[75] With nearly 8.2 million residents, more people live in New York today than ever before.

New York's economy—even after the 2008-2009 recessions—remains relatively strong. In 2010, the city had an unemployment rate of 9.5%—compared to 11.4% in Cleveland, 11.2% in Birmingham and 8.8% in New Orleans.[76] New York's 2006-9 poverty rate of 18.6% was lower than the three other cities examined in this article.[77] As Glaeser notes, while other cities continued to decline "New York came back."[78]

## VII. Conclusion

Perhaps the public is right—the first order of business in economic development is effective local government free of corruption.

As with most types of crime, prosecution alone is not an answer. To be effective, anti-corruption measures need to start with prevention. Monitoring and auditing efforts appear to have played a role in successful efforts to curb corruption in New York. In reality, the best response to corruption is more effective government and the replacement of a culture of corruption with a culture of government performance. Effective oversight in the absence of effective follow-through will lead to more and more prosecutions and some corruption reduction through deterrence and incapacitation. But real reform must go beyond the creation of compliance-based systems and proceed in concert with efforts to make government more efficient and effective.

Again, the international approach is instructive. The United Nations Convention Against Corruption begins with provisions related to prevention rather than enforcement. Moreover, those provisions center on the day-to-day operations of government rather than oversight—with specific focus on personnel, procurement and financial management.

The story of New York suggests that New Orleans and Cleveland may well be on the right track with new efforts to tackle their histories of local government corruption. In addition to taking on corruption for all of the reasons related to confidence in democracy, their efforts—and complementary efforts related to efficiency and effectiveness—may be the necessary predicate for an economic turnaround as well. For places like Birmingham, failure to pursue similar strategies may leave their economic future in jeopardy.

# APPENDIX

## Table 1
**Corruption Perception Index—2011[79]**

| | Rank | Score |
|---|---|---|
| Denmark | 1 | 9.3 |
| New Zealand | 1 | 9.3 |
| Singapore | 1 | 9.3 |
| Finland | 4 | 9.2 |
| Sweden | 4 | 9.2 |
| Canada | 6 | 8.9 |
| Netherlands | 7 | 8.8 |
| Australia | 8 | 8.7 |
| Switzerland | 8 | 8.7 |
| Norway | 10 | 8.2 |
| United States | 22 | 7.1 |
| Afghanistan | 176 | 1.4 |
| Myanmar | 176 | 1.4 |
| Somalia | 178 | 1.1 |

## Table 2
**Federal Public Corruption Convictions (per 100,000 residents)[80]**

| U.S. Attorney's Office | Total 2000 - 2009 | Population (2006 estimate) | Ten Year | | U.S. Attorney's Office | Total 2007-2009 | Three Year |
|---|---|---|---|---|---|---|---|
| Louisiana, Eastern | 230 | 1,430,660 | 16.08 | | Louisiana, Eastern | 75 | 5.24 |
| Kentucky, Eastern | 224 | 2,112,346 | 10.60 | | Mississippi, Northern | 44 | 4.00 |
| Mississippi, Northern | 98 | 1,099,204 | 8.92 | | Kentucky, Eastern | 77 | 3.65 |
| Tennessee, Western | 136 | 1,539,807 | 8.83 | | Alaska | 24 | 3.58 |
| Alaska | 55 | 670053 | 8.21 | | Florida, Northern | 49 | 2.96 |
| North Dakota | 51 | 635,867 | 8.02 | | South Dakota | 23 | 2.94 |
| Montana | 65 | 944,632 | 6.88 | | Virginia, Eastern | 152 | 2.79 |
| Louisiana, Middle | 52 | 766,514 | 6.78 | | Alabama, Northern | 74 | 2.74 |
| South Dakota | 52 | 781,919 | 6.65 | | Tennessee, Western | 39 | 2.53 |
| Florida, Southern | 404 | 6,199,204 | 6.52 | | Louisiana, Middle | 19 | 2.48 |
| Alabama, Middle | 68 | 1084887 | 6.27 | | Ohio, Northern | 115 | 1.96 |
| Alabama, Northern | 169 | 2698555 | 6.26 | | Oklahoma, Northern | 18 | 1.84 |
| West Virginia, Southern | 62 | 990,396 | 6.26 | | New Jersey | 155 | 1.78 |
| Pennsylvania, Eastern | 316 | 5,407,880 | 5.84 | | Missouri, Eastern | 50 | 1.73 |
| Florida, Northern | 95 | 1,654,469 | 5.74 | | Maryland | 92 | 1.64 |
| Ohio, Northern | 333 | 5,870,459 | 5.67 | | Montana | 15 | 1.59 |
| Virginia, Eastern | 303 | 5,450,696 | 5.56 | | North Dakota | 10 | 1.57 |
| Delaware | 46 | 853,476 | 5.39 | | Texas, Southern | 124 | 1.55 |
| Pennsylvania, Middle | 162 | 3,202,325 | 5.06 | | Delaware | 13 | 1.52 |
| Illinois, Southern | 64 | 1,275,132 | 5.02 | | Oklahoma, Eastern | 11 | 1.52 |

## Endnotes

1. In 2004 and 2005, the Council for Excellence in Government (CEG) and Goldman Sachs commissioned a series of surveys on economic development in six metropolitan areas—Kansas City, Fresno, Baton Rouge, Cleveland, Baltimore and San Antonio. In both Fresno and Baton Rouge—the only two areas where it was given as an option—a high percentage of respondents identified "an effective city and local government that is free of corruption" as an absolute priority to "creating a good environment for employment and for creating jobs." For example, in Fresno, 42 percent cited it as an absolute priority—compared to 41 percent for high quality schools and 30 percent for low taxes. In Baton Rouge, 48 percent cited it as an absolute priority, compared to 53 percent for high quality schools and 26 percent for low taxes. CEG and Goldman Sachs Jobs Survey, Study #7448, *available at* <http://ceg.files.cms-plus.com/FileDownloads/6_City_Combo.pdf> (last visited Sept. 10, 2011). *See also* Community Research Council, *State of Chattanooga Region Report: Quality of Life in the Chattanooga Region*, May 25, 2006. A survey of Hamilton County, Tennessee residents found that 86% indicated that effective local government free of corruption was the most important or very important factor to creating new jobs in the area.

2. United Nations, *The Cost of Corruption*, 2000, *available at* <http://www.un.org/events/10thcongress/2088b.htm> (last visited Sept. 10, 2011).

3. United Nations Office on Drugs and Crime, *United Nations Convention Against Corruption* iii (2004).

4. Transparency International, Corruption Perceptions Index 2010, <http://www.transparency.org/policy_research/surveys_indices/cpi/2010/in_detail#1> (last visited Sept. 10, 2011). The Index is based on a series of thirteen different surveys and assessments conducted and compiled over a two-year period. Transparency International has been publishing an annual index since 1995.

5. As Harvard economist Edward Glaser noted, "[E]ight of the ten largest U.S. cities in 1950 have lost at least a sixth of their population since then. Six of the sixteen largest cities in 1950—Buffalo, Cleveland, Detroit, New Orleans, Pittsburgh, and St. Louis—have lost more than half their population since that year." Edward Glaser, Triumph of the City 42 (Penguin Press 2011).

6. U.S. Dep't of Justice, Public Integrity Section, <http://www.justice.gov/criminal/pin> (last visited Sept. 10, 2011) (data is available in annual reports from 1978 to 2009). In a regularly updated table, the reports provide information on public corruption convictions by judicial district by year.

7. Prosecutors have discretion in the decision to charge and bring cases. Some may choose to emphasize corruption cases while others may focus on other federal offenses (e.g. narcotics). Prosecutors also have limitations on resources (e.g. staff) dictated by budgets. *See, e.g.* U.S. Dep't of Justice, United States Attorneys Manual Title 9, § 9-27.230(B)(1) (2002), *available at* <http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/27mcrm.htm#9-27.220>. "Federal law enforcement resources and Federal judicial resources are not sufficient to permit prosecution of every alleged offense over which Federal jurisdiction exists… United States Attorneys may establish their own priorities, within the national priorities, in order to concentrate their resources on problems of particular local or regional significance." *Id.*

8. Campbell Gibson, *Population of the 100 Largest Cities and Other Urban Places in the United States: 1790 to 1990*, Population Division, U.S. Census Bureau (1998), *available at* <http://www.census.gov/population/www/documentation/twps0027/twps0027.html> (last visited Sept. 10, 2011). Data for New Orleans population in 2005 is based on a Census Bureau estimate. Census Bureau, <http://www.census.gov/popest/cities/SUB-EST2009.html> (last visited Sept. 10, 2011).

9. The calculation is based on 2010 Census data for New Orleans. Census Bureau, <http://quickfacts.census.gov/qfd/states/22/22071.html> (last visited Sept. 10, 2011).

10. Data on the number of firms located in New Orleans and the number of individuals employed at firms located in New Orleans is from the County Business Pattern dataset. Census Bureau, <http://www.census.gov/econ/cbp/index.html> (last visited Sept. 10, 2011).

11. Individual poverty data for New Orleans is based on the results of the 2006, 2007, 2008 and 2009 American Community Survey administered by the Census Bureau. Census Bureau, <http://factfinder.census.gov/home/saff/main.html?_lang=en. 2000> Census tract level data on poverty is compiled by and is *available at* <http://www.dataplace.org> (last visited Sept. 10, 2011).

12. *See* Robert Penn Warren, All the King's Men (Houghton Mifflin Harcourt 2005). *See also* Steve Ritea, *Edwin Edwards begins 10-year sentence, saying, 'I will be a model prisoner,'* New Orleans Times Picayune, Oct. 22, 2002, *available at* <http://www.nola.com/crime/index.ssf/2002/10/edwin_edwards_begins_10-year_s.html>.

13. Frank Donze, *Oliver Thomas enters prison today*, New Orleans Times Picayune, Jan. 2, 2008, *available at* <http://www.nola.com/news/index.ssf/2008/01/oliver_thomas_enters_prison_to.html>.

14. *United States of America v. Anthony Jones*, Criminal Docket 10-340 (EDLA 2010), Bill of Information, *available at* <http://www.justice.gov/usao/lae/news/2010/downloads/factual_basis_anthony_jones.pdf>; Office of the United States Attorney, Eastern District, Louisiana, Greg Meffert, Former New Orleans Chief Technology Officer and "Deputy Mayor" Pleads Guilty to Federal Conspiracy, Bribery, Fraud, and Related Charges, Nov. 1, 2010, *available at* <http://www.justice.gov/usao/lae/news/2010/2010_11_01_gregory_meffert_plea.html> (last visited Sept. 10, 2011).

15. Press Release, Office of the U.S. Attorney, Eastern District, La., Former HANO CFO Sentenced to Almost 4 Years for Theft, Oct. 7, 2010, *available at* <http://www.justice.gov/usao/lae/news/2010/2010_10_07_elias_castellanos_sent.html>.

16. *United States v. Kenneth Bowen, et al*., Index No. 2:10-cr-00204 (E.D.La. 2010); Press Release, Office of the U.S. Attorney, Eastern District, La., *Six New Orleans Police Officers indicted in Danziger Bridge Case*, July 13, 2010, *available at* <http://www.justice.gov/usao/lae/news/2010/2010_07_13_danziger_ind.html>.

17. Home Rule Charter of the City of New Orleans, Sec. 9-401 (Oct. 2, 2010), *available at* <http://www.nola.gov/HOME/City-Information/City-Charter/>.

18. New Orleans City Code, Sec. 2-1120, *available at* <http://www.nolaoig.org/uploads/File/OIG%20Ordinance%202-1120.pdf>.

19. *See, e.g.*, Office of the Inspector Gen., City of New Orleans, A Performance Audit of Municipal Court's Remittances to the City (2011), *available at* <http://www.nolaoig.org/uploads/File/Audit/Municipal%20Court%20Final%201%2013%2011.pdf>.

20. New Orleans City Code, § 2-1121, *available at* <http://library.municode.com/index.aspx?clientId=10040&stateId=18&stateName=Louisiana> (accessed on July 21, 2011).

21. Letter from Mitch Landrieu, Mayor, City of New Orleans, to Eric Holder, Attorney General, U.S. (May 5, 2010) ("described by many as one of the worst police departments in the country").

22. Press Release, New Orleans Police Dep't, Superintendent Serpas reorganizes the New Orleans Police Department (June 25, 2010), *available at* <http://www.projectnola.com/police-alerts/view-all-nopd-e-alerts/94823-superintendent-serpas-reorganizes-the-new-orleans-police-department>.

23. U.S. Dep't of Justice, Civil Rights Div., Investigation of the New Orleans Police Department, Mar. 16, 2011.

24. City of New Orleans, *2011 Operating Budget*, Oct. 15, 2010 ("The Mayor's 2011 Budget was prepared using a process called Budgeting for Outcomes (BFO). Budgeting for Outcomes is a process designed to improve services and get a better return on investment of public dollars.")

25. The Office of Performance and Accountability, <http://www.nola.gov/GOVERNMENT/Chief-Administrative-Office/Office-of-Performance-and-Accountability> (last visited Sept. 10, 2011).

26. *See e.g.*, Robert D. Behn, *Designing PerformanceStat: Or What Are the Key Strategic Choices that a Jurisdiction or Agency Must Make When Adapting the CompStat/CitiStat Class of Performance Strategies?*, 32 Pub. Performance and Mgmt. Review 203, 203–32 (2008).

27. *See* Gibson, *supra* note 8.

28. Federal Reserve System and Brookings Institution Metropolitan Policy Program, *The Enduring Challenge of Concentrated Poverty in America, Community Case Study: Cleveland, Ohio*, 39 (2006), *available at* <http://www.frbsf.org/cpreport/docs/cleveland_oh.pdf> (last visited Sept. 10, 2011).

29. Data from the 2010 Census for Cleveland. Census Bureau, <http://www.census.gov> (last visited Sept. 10, 2011).

30. Data on manufacturing employment located in Cuyahoga County is from the County Business Pattern dataset. Census Bureau, www.census.gov/econ/cbp/index.html (last visited Sept. 10, 2011).

31. Data on the number of Cleveland residents employed in manufacturing and Individual poverty data for Cleveland is based on the results of the 2006, 2007, 2008 and 2009 American Community Survey. Census Bureau, <http://www.census.gov> (last visited Sept. 10, 2011).

32. Carol Poh Miller and Robert Anthony Wheeler, Cleveland: A Concise History 1796-1996, 178 (Indiana University Press 1997).

33. Community Research Partners and Rebuild Ohio, *$60 Million and Counting: The cost of vacant and abandoned properties to eight Ohio cities* (Feb. 2008), *available at* <http://www.rebuildohio.org> (last visited Sept. 10, 2011).

34. *Cleveland v. Ameriquest Mortgage Sec., Inc.*, 621 F. Supp. 2d 513, 536 (N.D.Ohio 2009).

35. The county corruption crisis has been extensively chronicled by the Cleveland Plain Dealer, with an online Cuyahoga County Corruption Scandal/County in Crisis website. Cuyahoga County's corruption investigation, A Comprehensive Guide, <http://www.cleveland.com/countyincrisis/index.ssf/2010/09/schemes_title_to_come.html> (last visited Sept. 10, 2011) (updated through the indictment of Commissioner Jimmy Dimora in Sept. 2010).

36. *United States of America v. Dimora*, Case No. 1:10CR387, (N.D.Ohio, Sep. 14, 2010) (superseding indictment filed on Mar. 30, 2011).

37. Press Release, Office of the U.S. Attorney, Northern District of Ohio, Sept. 9, 2010, *available at* <http://www.justice.gov/usao/ohn/news/2010/Russo.pdf>.

38. Mark Puente, *Gerald McFaul Sentenced to House Arrest for Theft, Ethics Offenses*, Cleveland Plain Dealer, July 26, 2010, *available at* <http://blog.cleveland.com/metro/2010/07/gerald_mcfaul_sentenced_for_th.html>.

39. Charter of Cuyahoga County, 2009, *available at* <http://charter.cuyahogacounty.us/pdf_transitioninfo/en-US/CuyahogaCountyCharter.pdf> accessed on July 1, 2011. *See* Sections 5.02 (creating a County Fiscal Officer), 5.08 (establishing the powers, duties and responsibilities of the appointed Sheriff) and Article IX (providing for an Internal Audit function).

40. Cuyahoga County Charter Transition, Recommendations of the Justice Services Workgroup (September 25, 2010), *available at*: <http://charter.cuyahogacounty.us/pdf_transitioninfo/en-US/JSW-PPtn-DraftRecomdtns-092510.PDF>.

41. Press Release, Office of the County Executive, FitzGerald Selects Federal Prosecutor as Inspector General (Jan. 12, 2011) (on file with author); Cuyahoga County, Oh., Ordinance CO2011-0019 (June 14, 2011), *available at* <http://council.cuyahogacounty.us/pdf_council/en-US/Legislation/Ordinances/2011/O2011-0019.pdf>.

42. *See* Gibson, *supra* note 8.

43. Data from the 2010 Census for Birmingham is available on the Factfinder interactive tool at <http://www.census.gov> (last visited July 21, 2011).

44. Diane McWhorter, Carry Me Home 41 (Simon & Schuster 2002) (Andrew Carnegie referred to Birmingham as "Pennsylvania's most formidable industrial enemy").

45. Data on the number of Birmingham residents employed in manufacturing and Individual poverty data for Birmingham is based on the results of the 2006, 2007, 2008 and 2009 American Community Survey administered by the Census Bureau, *available at*: <http://www.census.gov> (last visited July 21, 2011).

46. Wayne Flynt, Alabama in the Twentieth Century 84 (University of Alabama Press 2006).

47. *See* McWhorter, *supra* note 44.

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49. Press Release, Office of the U.S. Attorney for the Northern District of Ala., Federal Judge Sentences Former Birmingham Mayor and Former Jefferson County Commission President to 15 Years for Bribery Scheme (Mar. 5, 2010), *available at*: <http://www.fbi.gov/birmingham/press-releases/2010/bh030510.htm>.

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63. Gerald Benjamin & Frank J. Mauro, *The Reemergence of Municipal Reform*, 37(3) Proceedings of the Acad. of Political Sci. (1989).

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66. Frank Anechiarico & James Jacobs, The Pursuit of Absolute Integrity 84-87 (University of Chicago Press 1996).

67. *See* David R. Eichenthal, The Other Elected Officials in Urban Politics: New York Style 96 (M.E. Sharpe, Inc. 1990) ("The comptroller's power to audit the expenditure of city funds is at the core of his or her role as the city's chief fiscal officer…By exercising this audit authority, the comptroller can comment on and criticize the executive's capacity to implement virtually every city policy. This power is unique to the comptroller…").

68. *See* New York City Charter, *supra* note 62, at § 311. The rules for the Procurement Policy Board are *available at* <http://www.nyc.gov/html/mocs/ppb/downloads/pdf/April2010rulesmodifiedMar2011pdf.pdf> (last visited July 21, 2011).

69. *See* New York City Charter, *supra* note 62, at § 2602.

70. N.Y.C. Admin. Code § 3-211-223.

71. A history of the New York City Campaign Finance Board is *available at* <http://www.nyccfb.info/press/info/history.aspx> (last visited on July 21, 2011). ("In response to corruption scandals in the mid-1980's, a series of ethics reforms is enacted. Most notable of these was the Campaign Finance Act, adopted on February 29. A Charter revision approved by the public through a city referendum established the Campaign Finance Board (CFB), an independent and nonpartisan agency charged with limiting the role and influence of private money in the political process. This is accomplished by providing public matching funds to candidates for city office to run their campaigns.").

72. *See* Anechiarico & Jacobs, *supra* note 66, at xiv-xv ("Our thesis is that the anticorruption machinery has had profound, complicating, and often negative implications for the organization and operation of public administration").

73. *See e.g.*, Joseph Goldstein & Al Baker, *Risks Aside, Ticket-Fixing Has Persisted for Decades*, N.Y. Times, Apr. 24, 2011, *available at* <http://www.nytimes.com/2011/04/25/nyregion/despite-well-known-risks-ticket-fixing-is-nothing-new.html?ref=ticketfixingscandal> ("In 1951, police officers in Manhattan's 20th Precinct were investigated for sabotaging paperwork to kill traffic citations, as favors for politicians.") (last visited July 1, 2011); Patrice O'Shaughnnesy & Corey Siemaszko, *In Bloomberg's CityTime scandal, echoes of the '86 PVB fiasco that nearly toppled Ed Koch*, N.Y. Daily News, Dec. 19, 2010, *available at* <http://articles.nydailynews.com/2010-12-19/local/27084816_1_ed-koch-geoffrey-lindenauer-parking-violations-bureau> ("The mushrooming CityTime payroll probe is an eerie echo of a 1986 scandal that stripped the clean government veneer off the administration of another popular New York mayor") (last visited July 1, 2011).

74. For discussion of data source *see* U.S. Dep't of Justice, *supra* note 6.

75. *See* Gibson, *supra* note 8; *see also supra* note 43 (data from the 2010 Census for New York available on the Factfinder interactive tool at <http://www.census.gov> (last visited July 21, 2011).

76. Local Area Unemployment Statistics data from the Bureau of Labor Statistics is *available at* <http://www.bls.gov/lau> (last visited July 1, 2011).

77. Individual poverty data is based on the results of the 2006, 2007, 2008 and 2009 American Community Survey administered by the Census Bureau, *available at*: <http://www.census.gov> (last visited July 1, 2011).

78. *See* Glaeser, *supra* note 5, at 56.

79. Transparency International, *supra* note 4 (*see* Table 1 reprinted above).

80. Per capita rates were developed on the basis of data for the population of individual judicial districts for the year 2006 (based on Census estimates). Census, interactive function, <http://www.fedstats.gov/qf/> (last visited Sept. 10, 2011).

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