



U.S. CHAMBER
Institute for Legal Reform



Enforcement Slush Funds

*Funding Federal and State Agencies
with Enforcement Proceeds*

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U.S. CHAMBER
Institute for Legal Reform

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Introduction

There is currently a growing practice that is threatening core constitutional, legal and ethical norms that undergird our legal system: the use of public settlement money by federal and state prosecutors absent legislative approval. Whether it is federal law enforcement officials retaining the proceeds of enforcement actions for their own use or state attorneys general steering public money generated from litigation settlements to their preferred projects and charities, the practice raises serious constitutional, statutory and ethical issues that require careful attention.

The first piece featured in this paper, *Profit Over Principle: How Law Enforcement for Financial Gain Undermines the Public Interest and Congress's Control of Federal Spending*, focuses on federal law enforcement officials' use of public money for their own agency purposes, as well as the growing practice of doling out public money to favored charitable organizations. The second piece featured in this paper, *Undoing Checks and Balances: State Attorneys General and Settlement Slush Funds*, explores the practice by which state attorneys general are spending public settlement money on their favored projects and donating money to hand-picked charitable organizations, as well as enhancing their office budgets.

As both of these pieces highlight, these practices—which involve the expenditure of public money—are being carried out with virtually no legislative oversight. Federal law enforcement officials and state attorneys general are spending public money without legislative approval, thereby contravening the separation of powers firmly rooted in the federal and state constitutions. Under both federal and state constitutions, the power to raise and spend the people's money is vested exclusively in the legislatures, whose members are considered the representatives most accountable to the people and therefore the only ones who should be allowed to spend the people's money. Beyond violating this well-established constitutional principle,

these practices also sidestep specific statutes that require public money to be deposited in the treasury. In addition, these practices raise a host of ethical issues, not the least of which is the specter that law enforcement officials' decisions will be guided by profit motivations or political

aspirations as opposed to furthering the public interest. The two pieces included in this publication delve into these issues in great detail and will hopefully prompt greater public awareness of this growing threat to our legal system.

Profit Over Principle: How Law Enforcement for Financial Gain Undermines the Public Interest and Congress's Control of Federal Spending

“Self-funding” of federal law enforcement has grown dramatically in recent years, with extremely disturbing consequences.

Permitting prosecutors to retain billions of dollars obtained through law enforcement settlements allows the profit motive to trump prosecution in the public interest: Law enforcement officials have a strong incentive to focus on maximizing revenue rather than exercising their discretion to further all aspects of the public interest, which may mean targeting wrongdoers that don't have significant profit potential.

In addition, prosecutors and regulators are increasingly using their authority to force targets of enforcement activity to make “donations” to favored third-party organizations without Congressional authorization.

These practices raise serious constitutional concerns under Article I, which grants to Congress—and to Congress alone—the power to control and direct spending from the public fisc. By vesting Congress with this “power of the purse,” the Framers

intended both to create a structural check against arbitrary Executive power and to increase transparency by subjecting public spending to legislative oversight. The burgeoning practice of allowing the Executive to engage in “for-profit public enforcement” actions—funding its own operations out of recoveries and transferring proceeds to private allies and supporters—undermines these core constitutional objectives. This concentration of unchecked Executive authority represents a serious

threat to our constitutional separation of powers framework. It also imperils the effectiveness of government enforcement efforts by placing critical spending and priority questions beyond public scrutiny.

Just as significantly, prosecutors' and regulators' own profit motives can outweigh other important public interest considerations—which is particularly disturbing given the broad, unreviewable discretion that they exercise in the law enforcement context. In the nineteenth

century, tax collectors and customs officers received a percentage of the funds they recovered for the government, but that system was abandoned because it elevated self-interest over the public interest.

Today's system of prosecution for profit suffers from precisely the same flaw and requires the same remedy: Congress can and must take the profit motive out of law enforcement by requiring that all proceeds of law enforcement activities be deposited into the federal treasury.

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Congress's Power of the Purse: A Key Protection Against Executive Tyranny

Article I of the Constitution provides that “[n]o money shall be drawn from the Treasury, but in Consequence of Appropriations made in Law” by Congress.¹

It further requires that “[a]ll Bills for raising Revenue shall originate in the House of Representatives.”² These two provisions together grant Congress the “power of the purse,” vesting the legislature alone with the authority to collect and expend public funds.

The Framers viewed Congress's exclusive control over public spending as a bulwark against abuse of power by the Executive Branch, protecting the nascent American democracy from backsliding into tyranny. As James Madison wrote in 1788, “this power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people....”³ The Congressional power of the purse, therefore, is central to both the separation of powers and the preservation of representative democracy itself; as Madison explained, it is rooted in the principle that the people's immediate elected representatives “cannot only refuse, but they alone can propose, the supplies requisite for the support of government.”⁴

Thus, “the power of the purse is more than a procedural device to fence in the Executive; it is also a way of ensuring that spending decisions are made by the more representative and open political institution.”⁵ Legislative control over expenditures guarantees that the Federal Government's spending decisions reflect the views of the people as a whole, rather than just the narrow interests of whatever faction happens to control the Executive Branch. That principle derives not only from centuries of Anglo-American legal tradition,⁶ it also follows from the fundamental

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principle for which the American Revolution was fought: an abhorrence of “taxation without representation.”⁷ For the Framers, therefore, securing for the people’s elected representatives in Congress the power to direct the way in which public funds are spent constituted a foundational principle of American constitutional democracy.

That constitutional protection is being eroded to a significant degree. Federal law enforcement agencies often retain the proceeds of the fines, penalties and settlements they obtain through enforcement and expend them at their own discretion, enabling the Executive to

circumvent the checks that otherwise apply in the legislative appropriations process and creating a host of perverse incentives for enforcement. With these proceeds, the Executive Branch can sustain and grow permanent bureaucracies that are not supported by funding from Congress but rather depend upon the Executive’s own continued efforts to finance the activities. In addition, agencies can, and often do, selectively steer proceeds to external private parties that support the narrow policy objectives of the Executive Branch—wholly without Congressional authorization.

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Law Enforcement Officials Are Obligated To Make Decisions Based On the Public Interest

Federal prosecutors and regulators who exercise law enforcement authority are endowed with extraordinarily broad discretion. Unlike other government actions, prosecutorial decisions are largely exempt from judicial review—even if the decision is arbitrary and capricious, it cannot be challenged.⁸

The only exception is selective prosecution claims based on violations of constitutional protections—such as the prohibition against discrimination based on race or targeting based on speech—but the standards for such a claim are extremely demanding.⁹

Prosecutors are supposed to exercise this broad discretion to further the public interest. The U.S. Department of Justice’s strategic plan properly emphasizes that “[u]pholding the laws of the United States is the solemn responsibility entrusted to DOJ by the American people. The Department enforces these laws fairly and uniformly to ensure that all Americans receive equal protection and justice.”¹⁰

This focus on the public interest results from recognition of the harm produced by enforcement decisions based on prosecutors’ self-interest. “[N]ot too long ago, public enforcers often were compensated in ways that were tied directly to their enforcement efforts. Tax collectors retained some of the taxes they collected,

customs agents profited directly from the duties they collected, and prosecutors were paid per conviction.”¹¹

But “[m]ost U.S. jurisdictions abandoned such payment schemes by the turn of the twentieth century, due in large part to concerns that bounty-based public enforcement would result in the same kind of overzealousness—a failure to exercise appropriate prosecutorial discretion—that

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we have come to expect from private enforcement. This historical episode, while largely forgotten, served to cement the tradition of fixed salaries for public employees, 'mak[ing] the absence of the profit motive a defining feature of government.'"¹²

Unfortunately, the profit motive is returning to government law enforcement decision-making. The Executive Branch has increasingly devised new ways to generate revenue outside of the appropriations process by engaging in ever more aggressive (and lucrative) enforcement

tactics. Indeed, as commentators have observed with growing alarm in recent years, the financial incentives created by allowing Executive agencies to retain enforcement proceeds has transformed law enforcement into "big business," with "[p]ublic enforcers at both the state and federal levels bring[ing] in billions of dollars each year as the result of settlements and court judgments."¹³ Targeting potential defendants that offer the biggest potential payday, rather than targeting the most serious wrongdoers, is a growing focus of federal prosecutors and regulators.

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For-Profit Enforcement: A Growing Trend

Federal law provides that “an official or agent of the Government receiving money for the Government from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim.”¹⁴

Notwithstanding this statute, however, an increasing number of federal laws now authorize law enforcement agencies to retain all or some of the money that they recover through enforcement, whether as the result of settlements, administrative actions, or judgments. These agencies are then free to expend these sums to support their activities—as discretionary “slush funds” supplementing the monies appropriated by Congress. Scholars have dubbed this phenomenon “for-profit public enforcement.”¹⁵

The practice of funding agencies through for-profit enforcement activity has grown substantially over the past two decades, with an increasing number of Executive agencies becoming less and less dependant upon the normal legislative appropriations process. As the non-exhaustive examples below illustrate, this trend has created perverse incentives for certain types of enforcement actions and a great capacity for abuse. And most importantly, it poses a direct challenge to our system of representative democracy by creating a class of Executive activity outside the constitutionally-mandated appropriations process.

The Consumer Financial Protection Bureau

One stark example of the lack of oversight occasioned by for-profit enforcement can be seen in the Consumer Financial Protection Bureau (CFPB). Created in 2010 by the Dodd-Frank Wall Street Reform Act (Dodd-

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Frank), the CFPB operates entirely outside of the Congressional appropriations process. Its annual operating budget is wholly funded by monies provided by the Federal Reserve.¹⁶ For Fiscal Year 2015, the CFPB will receive an estimated \$583.4 million in up front funds, with approximately half that amount dedicated to enforcement activities.¹⁷ The remaining funds are allocated to initiatives such as “[e]mpower[ing] consumers to live better financial lives” and “[a]dvanc[ing] the CFPB’s performance by maximizing resource productivity.”¹⁸ There is very little public visibility into what these initiatives actually mean.

These funds are supplemented by money generated from the CFPB’s enforcement efforts. The proceeds of litigation settlements and judgments (primarily entered into by the large financial institutions that the CFPB regulates and targets) are placed into the CFPB’s “Civil Penalty Fund” rather than the general treasury.¹⁹ While the ostensible purpose of the Civil Penalty Fund is to compensate the victims of consumer protection violations, the CFPB’s rules actually allow it to utilize the fund to pay for agency activities, such as “consumer education and financial literacy programs.”²⁰ It appears that the vast majority of the recovered funds are indeed consumed by the agency.

By the CFPB’s own estimate, the Civil Penalty Fund collected approximately \$91.5 million by the end of Fiscal Year 2014.²¹ Of that, only about \$13 million—less than 15 percent of all funds recovered—was used to compensate harmed consumers.²² The remaining 86 percent had been used exclusively to fund the CFPB’s own operations or remained in the CFPB’s coffers

for future use.²³ It is virtually impossible to determine how these funds are being spent, as the CFPB submits only highly general reports on its use of these funds.

In sum, “Dodd-Frank put the CFPB inside the Fed, but insulated it from oversight by almost everyone in the federal government.... The bundle of autonomy mechanisms, along with the independent-agency-within-an-independent-agency structure, gives the CFPB unmatched insulation from the accountability devices that apply to all other federal regulators.”²⁴ Exempt from the congressional appropriations process, the CFPB has become “one of the most powerful and publicly unaccountable agencies in American history.... No other branch or agency can control the CFPB’s budgetary

“The CFPB’s unilateral authority—existing beyond the bounds of legislative oversight and without direct accountability to the public—is an affront to the Constitution’s guarantee that control over spending will ultimately rest with the people’s elected representatives in the Legislative Branch.”

appropriations, regulations, or enforcement decisions.”²⁵ The CFPB’s unilateral authority—existing beyond the bounds of legislative oversight and without direct accountability to the public—is an affront to the Constitution’s guarantee that control over spending will ultimately rest with the people’s elected representatives in the Legislative Branch.

The Departments of Justice and Health and Human Services

Another example of federal authority exempt from Congress’s appropriations power is provided by the enforcement bureaucracy that has been created by the Department of Justice (DOJ) and Department of Health and Human Services (HHS).

The Health Insurance Portability and Accountability Act (HIPAA) authorizes DOJ and HHS to maintain a revolving enforcement fund called the Health Case Fraud and Abuse Control Account.²⁶ This account is essentially a slush fund for the proceeds of all fines, settlements, and civil penalties imposed in healthcare fraud enforcement actions, including all Medicare fraud cases brought by DOJ under the False Claims Act.²⁷ Under HIPAA, DOJ and HHS are permitted to decide how much of the revolving enforcement fund to use to finance additional antifraud efforts, fund the hire of new prosecutors and investigators, and support a perpetually growing array of investigative and enforcement activities—and how much should be deposited into the Medicare Trust Fund (thereby reducing the cost of Medicare).²⁸

This self-funding mechanism, which exists entirely outside of the normal appropriations process, has proven to be a major boon for

both DOJ and HHS. In Fiscal Year 2013, for example, the agencies jointly won or negotiated over \$4.33 billion in healthcare-related judgments and settlements from private parties.²⁹ Although some of this money was ultimately returned to the general treasury in the form of deposits made to the Medicare Trust Fund, a significant portion—over half—was retained by DOJ and HHS for their exclusive use, at the discretion of the HHS Secretary and Attorney General.³⁰

Much of this money has been used to create and sustain a new enforcement bureaucracy. Since 2009, HHS and DOJ have devoted enforcement proceeds toward a specialized joint task force, dubbed the Health Case Fraud Prevention & Enforcement Action Team (HEAT), with subsidiary regional “Medicare Fraud Strike Force teams” comprised of “top level law enforcement agents, prosecutors, attorneys, auditors, evaluators, and other staff from DOJ and HHS and their operating divisions.”³¹ Congress has never authorized creation of such a task force. Nevertheless, DOJ and HHS have used their enforcement revenues to sustain this self-created bureaucracy, “facilitat[ing] staff increases and other measures to aid ‘the fight against health care fraud and abuse.’”³² The unilateral creation of this bureaucracy by two federal agencies, without any of the checks and balances of the appropriations process, should be disconcerting to anyone who believes—as the Framers did—that control over public spending should rest with the people’s elected legislative representatives and not with the Executive Branch. And the need to continue to generate large sums to support this bureaucracy inevitably forces law enforcement officials to skew their

enforcement decisions to keep the funds flowing. That means targeting companies and setting settlement demands in order to generate revenue, and not on the basis of the overall public interest.

DOJ's Asset Forfeiture and Equitable Sharing Program

DOJ also has independent statutory authority to retain the proceeds of assets that it seizes as the result of civil or criminal forfeiture. Congress initially granted DOJ this authority in the 1980s, in an attempt to help finance the “War on Drugs” by allowing DOJ to seize and use cash recovered in drug busts.³³ Over the years,

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however, DOJ's forfeiture programs have expanded to reach all manner of other alleged criminal activity, including securities fraud and financial offenses. As the types of crimes targeted has grown, so too has the revenue generating potential of asset forfeiture. In a single large fraud case, for example, the proceeds of a seizure can potentially range into the tens or hundreds of millions of dollars.

Allowing law enforcement officers to retain and use such large amounts of money for their own purposes creates a significant economic incentive for them to employ this broad authority to generate ever-increasing amounts of revenue simply to support expansion of the enforcement bureaucracy—and ignore other aspects of the public interest. That is precisely what DOJ has done.

Asset forfeiture actions have grown exponentially in size and frequency over the past two decades. In 1985, when DOJ's asset forfeiture fund was first initiated, it took in only approximately \$27 million annually. By 2011, that figure had ballooned to \$1.8 billion.³⁴ According to the Government Accountability Office (GAO), DOJ's annual forfeiture proceeds more than tripled each year between 2003 and 2011, due to “an increase in forfeitures resulting from fraud and financial crimes investigations.”³⁵ As the GAO explained, DOJ both used these funds to “cover [its own] costs of forfeiture activities” and “share[d] forfeiture proceeds with state and local agencies that participate in joint investigations through its equitable sharing program.”³⁶

At the time of its 2012 report, the GAO warned that DOJ's equitable sharing program—which allowed state and local

police departments to share in the spoils of asset seizures—needed stronger “controls to ensure consistency and transparency.”³⁷ These warnings ultimately proved prescient.

Assets seizures by DOJ generally take place during the investigation process, rather than at the time of prosecution. The law allows officers to take control of any assets that the officer believes are connected to illicit activity using “civil asset forfeiture” powers during the pendency of an investigation, without requiring the filing of criminal charges. And because civil forfeiture requires the Government to meet a lesser burden of proof than the “reasonable doubt” standard that ultimately applies at a criminal trial, the process essentially allows the Government to seize property even when the evidence does not ultimately support a criminal prosecution.

Commentators have explained that allowing authorities to retain forfeited assets can distort legitimate enforcement priorities by incentivizing the pursuit of more valuable assets rather than more dangerous criminals and encouraging authorities to divert investigative resources away from those cases that are less likely to produce lucrative asset seizures.³⁸ This can also lead to serious conflicts-of-interest.

As Professors Blumenson and Nilsen observed:

The most intuitively obvious problem presented by the forfeiture and equitable sharing laws is the conflict of interest created when law enforcement agencies are authorized to keep the assets they seize. It takes no special sophistication to recognize that this incentive constitutes a compelling invitation to police departments to stray from legitimate law enforcement goals in order to maximize funding for their operations.³⁹

The full scope of this problem burst into public view in September 2014, when the *Washington Post* published a six-part investigative exposé detailing how state and local police departments—working with DOJ under the equitable sharing program—had “made cash seizures worth almost \$2.5 billion from motorists and others without search warrants or indictments.”⁴⁰ The *Post*’s investigation determined that officers “routinely pulled over drivers for minor traffic infractions, pressed them to agree to warrantless searches and seized large amounts of cash without evidence of wrongdoing.”⁴¹ Equally disturbing, the *Post* found that “[p]olice spent the seizure proceeds with little oversight, in some

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cases buying luxury cars, high-powered weapons and military-grade gear such as armored cars.”⁴² In the wake of the *Post*’s report, Attorney General Eric Holder was forced to impose new limits on DOJ’s equitable sharing program.⁴³ Many observers continue to question, however, whether DOJ’s self-imposed and self-enforced limits will actually achieve accountability or transparency.⁴⁴

The widespread abuses in DOJ’s asset forfeiture program were both predictable and preventable. Had the billions of dollars doled out through the equitable sharing program been subject to the rigorous oversight and review of the Congressional appropriations process, it is unlikely that funds would have been misspent. Likewise, had enforcement operations been funded through the normal legislative channels, the perverse incentives that encouraged officers to prioritize grabbing the biggest recoveries over stopping the most serious crimes

“ [H]ad enforcement operations been funded through the normal legislative channels, the perverse incentives that encouraged officers to prioritize grabbing the biggest recoveries over stopping the most serious crimes would not have existed. ”

would not have existed. Instead, without the check of Congressional oversight, law enforcement officers were allowed to use their authority to advance their own narrow interests—funding salary increases, better perks, new hires, and bigger enforcement operations—at the expense of the rights and liberties of individual citizens. The resulting abuses reflect precisely the danger that the Framers had hoped to avoid by granting the power of the purse to Congress rather than to the Executive Branch. The facts producing these asset forfeiture abuses are not unique. Even after the reforms noted above, federal law still permits DOJ to retain for its own use three percent of every amount recovered for the federal government.⁴⁵

The Environmental Protection Agency

Another federal agency that has increasingly implemented a for-profit enforcement model is the Environmental Protection Agency (EPA). Although “[m]any, both within Congress and outside of it, have accused the agency of reaching beyond the authority given it by Congress and ignoring or underestimating the costs and economic impacts of proposed and promulgated rules,”⁴⁶ the EPA has routinely sought to stretch its enforcement authority to its outermost limits in recent years. This aggressive stance has generated significant revenues, with the EPA taking in approximately \$250 million annually in civil and criminal penalties alone.⁴⁷ These totals do not include the massive sums that the EPA extracts from private parties through settlements relating to monitoring and remediation of Superfund sites, which constitute a large and often opaque source of additional funding for the agency.

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) authorizes the EPA to maintain a revolving enforcement trust fund to hold the proceeds of any settlements that it enters related to a Superfund site.⁴⁸ And under the express language of CERCLA, the President has discretion to retain and deploy any recovered settlement funds as he sees fit.⁴⁹ This authority operates as a blank check to the Executive to engage in selective enforcement (targeting the richest potential recoveries rather than the most contaminated sites) and to spend public funds without any legislative oversight or transparency.

The recoveries made (and then spent) by the EPA under CERCLA are both massive and almost entirely hidden from public view. For example, in a single settlement in 2014, the EPA required the estate of a bankrupt petroleum company to pay \$5.15 billion to resolve a series of environmental and tort claims.⁵⁰ According to the EPA, it earmarked more than \$2 billion from that recovery “for cleanup work associated with numerous EPA-lead sites, resulting in the largest bankruptcy-related award that the EPA has ever received for environmental claims and liabilities.”⁵¹ But the agency has provided little or no public information about its plans for the rest of the funds. Indeed, even for those allocations and

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clean-up sites that it has publicly disclosed, the EPA’s statements have been confoundingly short on details.

To take just one example, the EPA has said it intends to spend nearly \$17 million in recovered funds on “administrative funding.”⁵² It has not, however, provided an itemized breakout of this planned expenditure. These types of vague descriptions of expenditures are common, and they impair the public’s ability to assess the integrity and effectiveness of EPA spending. Without Congress shining a light on the EPA’s CERCLA spending, therefore, the public has little ability to evaluate the agency’s priorities. Nor can it constrain the EPA’s expenditures if they fail to advance the public interest. In effect, Congress has ceded its constitutional responsibility to protect the public to the Executive Branch.

Unauthorized Distribution of Public Funds to Private Parties

In addition to using for-profit enforcement to finance their own activities, Executive agencies also commonly steer settlement proceeds to private parties that are sympathetic to their policy goals. Nowhere is this practice more prevalent than in DOJ's use of Non-Prosecution Agreements (NPAs) and Deferred Prosecution Agreements (DPAs).

The ostensible purpose of NPAs and DPAs is to resolve a criminal case prior to the filing of formal charges; they reflect an agreement between the Government and a specific accused defendant under which the defendant agrees to perform certain obligations in order to avoid indictment. Unlike plea bargains, NPAs and DPAs are not subject to review or approval by any court, meaning prosecutors have free reign to impose settlement terms and conditions. Indeed, corporate defendants in particular often have no choice but to accept harsh NPA and DPA conditions because the mere filing of an indictment or a criminal charge against a business can cause its share prices to plummet, permanently damage its reputation, and place its operating licenses, government contracts and existing customers at risk. Against this backdrop, prosecutors have increasingly relied upon NPAs and DPAs as preferred tools in dealing with corporate defendants. Since 2004, the Justice Department has entered more than

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200 such agreements, virtually all in white-collar crime cases that involve corporate defendants.⁵³ Since 2009, the total value of fine and penalties imposed upon corporate defendants under such agreements has reached more than \$3 billion annually.⁵⁴

One condition frequently contained in NPAs and DPAs is some form of mandatory charitable contribution. This practice, dubbed “extraordinary restitution,” generally requires the investigation target (almost always a large corporation) to make a large payment to an organization of the Government’s choosing (often a university, environmental organization, or consumer advocacy group).⁵⁵ Typically, the agreements themselves describe these payments as “voluntary donations.” But as Professor Paul Larkin observed, “[t]he catch...is that the target of the investigation cannot claim the income tax deduction otherwise available under federal law for voluntary gifts. In fact, because the payment is a condition of avoiding indictment or trial, which could be tantamount to capital punishment for some businesses, ‘extraordinary restitution’ payments are no more ‘voluntary’ than shotgun weddings.”⁵⁶

Most recently, DOJ settlements of claims against large banks have included provisions requiring the banks to make donations of hundreds of millions of dollars to private groups meeting criteria specified by the Justice Department.⁵⁷ Members of Congress and other observers have criticized these payment requirements on the ground that they circumvent the congressional appropriations process.⁵⁸

In many cases, these mandatory payments to private organizations have little or no connection to the actual offenses being investigated. In 2012, for example, the

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Justice Department required the Gibson Guitar Corporation to pay a \$300,000 fine to settle an alleged violation of a restriction on wood imports.⁵⁹ On top of the fine, Gibson was also required to make a \$50,000 “community service payment” to the National Fish and Wildlife Foundation (NFWF), even though that entity was not a victim of and had no direct relationship to the alleged offense.⁶⁰ The NFWF received an even bigger windfall in 2012, when the Government required British Petroleum to “donate” nearly \$2.5 billion to the Foundation over a five-year period, in connection with resolving a criminal investigation related to the Gulf of Mexico oil spill.⁶¹ No part of this settlement agreement—neither the size of the fine nor the decision to direct billions in proceeds to a single non-governmental organization—was authorized or approved by Congress. Indeed, shortly after the BP settlement was announced, Louisiana Senator Mary Landrieu (whose state was arguably the biggest victim in the Gulf of Mexico spill) complained publicly about DOJ’s decision to direct so much recovery money to a single foundation, the board of which “include[d] only one person from the Gulf of Mexico.”⁶²

More distressing than the lack of a direct connection between the alleged offenses and the recipients of these extraordinary restitution payments is DOJ's utter lack of legal authority to require them in the first place. There is no federal statute that authorizes DOJ to show selective preference to certain private organizations in this way, nor does the Constitution generally allow the Executive to unilaterally direct public funds to preferred private organizations. For example, to the extent the BP oil spill-related recovered funds are intended to compensate for diffuse public harms, then those funds belong to the public and should be paid into the general treasury to be appropriated according to a representative legislative process. By using the NPA and DPA process, however, DOJ has doled such funds out to special interest groups without allowing for any Congressional oversight.

The widespread use of "extraordinary restitution" under NPAs and DPAs has created a significant capacity for abuse by allowing individual prosecutors to use public funds to support their own personally preferred causes and political allies. For example, in February 2006, the U.S. Attorney for Connecticut required a wastewater treatment firm accused of violating the Clean Water Act to "donate" \$1 million to the Alumni Association for the United States Coast Guard Academy in New London, Connecticut, to fund an Endowed Chair of Environmental Studies.⁶³ The wastewater treatment firm was also forced to pay an additional \$1 million to the Greater New Haven Water Pollution Control Authority in New Haven, Connecticut, to fund unspecified "environmental improvement projects."⁶⁴ Again, neither payment was authorized by Congress.

Not coincidentally, New London and New Haven—the two towns to which these pork barrel funds were directed—are both important centers of gravity in Connecticut state politics.

As these cases illustrate, the practice of "extraordinary restitution" provides yet more evidence of the risks inherent in untethering public spending and enforcement from the legislative oversight and authorization envisioned by the Constitution. As with the example of DOJ's asset forfeiture program, allowing the Executive to control and distribute public funds recovered pursuant to NPAs and DPAs has resulted in myriad abuses and repeated attempts by individual Executive officers to advance their own interests at the expense of the public.

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Conclusion

Prosecution for profit has become endemic in the federal government, with extremely damaging consequences. Federal law enforcement officials have strong incentives to focus on maximizing revenues in order to maintain or even increase the size of their agencies and to ignore other public interest considerations, such as targeting wrongdoers whose acts damage the public but who do not have the potential to provide large dollar recoveries.

At the same time, Congress's constitutional authority to determine the size and activities of the Executive Branch—and to establish the standards for any federal grants to private parties—is increasingly diminished. Reassertion of Congressional control is

essential to eliminate the skewed incentives for law enforcement and restore the essential constitutional protection provided by Congress's control over the size and scope of the federal government.

Endnotes

- 1 U.S. CONSTITUTION, Art. I, Sect. 7, Cl. 1.
- 2 *Id.* at Art. I, Sec. 7, Cl. 1.
- 3 FEDERALIST NO. 58, at 298 (James Madison) (Ian Shapiro ed., 2009).
- 4 *Id.* (emphasis added).
- 5 Senator Robert C. Byrd, “The Control of the Purse and the Line Item Veto Act,” 35 HARV. J. LEG. 297, 312 (1998).
- 6 *See id.* at 301-02 (tracing the origins of the legislative “power of the purse” to 15th century England, the Magna Carta, and the first English Bill of Rights); *see also* Paul Einzig, THE CONTROL OF THE PURSE: PROGRESS AND DECLINE OF PARLIAMENT’S FINANCIAL CONTROL at 79 (1959).
- 7 *See* DECLARATION AND RESOLVES OF THE FIRST CONTINENTAL CONGRESS, at Res. 4 (Oct. 14, 1774) (rejecting the “idea of taxation, internal or external for raising revenue on the subjects in America, without their consent”).
- 8 *Heckler v. Chaney*, 470 U.S. 821 (1985). “In the ordinary case, ‘so long as the prosecutor has probable cause to believe that the accused committed an offense defined by statute, the decision whether or not to prosecute, and what charge to file or bring before a grand jury, generally rests entirely in his discretion.’” *United States v. Armstrong*, 517 U.S. 456, 464 (1996) (quoting *Bordenkircher v. Hayes*, 434 U.S. 357, 364 (1978)).
- 9 *See, e.g., United States v. Armstrong*, 517 U.S. at 464-66.
- 10 U.S. Department of Justice, *Fiscal Years 2014-2018 Strategic Plan 3* (2013), available at <http://www.justice.gov/sites/default/files/jmd/legacy/2014/02/28/doj-fy-2014-2018-strategic-plan.pdf#s1>.
- 11 Margaret H. Lemos & Max Minzer, “For-Profit Public Enforcement,” 127 HARV. L. REV. 853, 862 (2014).
- 12 *Id.*
- 13 *Id.* at 854.
- 14 31 U.S.C. § 3302 (b).
- 15 *See* Lemos & Minzer, *supra* n. 8.
- 16 *See* Dodd-Frank, 12 U.S.C. § 5497.
- 17 CFPB Release, “Strategic plan, budget, and performance plan and report” (2014), at 12, available at <http://files.consumerfinance.gov/f/strategic-plan-budget-and-performance-plan-and-report-FY2013-15.pdf>.
- 18 *Id.* at 10.
- 19 *See* 12 C.F.R. § 1075.100 (describing the CFPB’s administration of the fund).
- 20 *Id.*
- 21 *See* CFPB Release, *supra* n. 12, at 22.
- 22 *Id.*
- 23 *Id.*
- 24 David A. Hyman & William E. Kovacic, “Why Who Does What Matters: Governmental Design and Agency Performance,” 82 GEO. WASH. L. REV. 1446, 1488 (2014).
- 25 Todd Zywicki, “The Consumer Financial Protection Bureau: Savior or Menace,” 81 GEO. WASH. L. REV. 856, 875 (2013).
- 26 47 U.S.C. § 1395i(k).
- 27 *See* 31 U.S.C. § 3729 *et seq.*
- 28 *See* 47 U.S.C. § 1395i(k).
- 29 HHS & DOJ, “Health Care Fraud and Abuse Control Program, Annual Report for Fiscal Year 2013” at 8. (Feb. 2014), available at <http://oig.hhs.gov/publications/docs/hcfac/FY2013-hcfac.pdf>.
- 30 *Id.* at 5.
- 31 *Id.* at 8.
- 32 *See* Lemos & Minzer, *supra* n. 8, 127 Harv. L. Rev. at 865 (quoting Kathleen S. Swendiman & Jennifer O’Sullivan, Cong. Research Serv. 97-895 A, HEALTH CARE FRAUD: A BRIEF SUMMARY OF LAW AND FEDERAL ANTI-FRAUD ACTIVITIES at 11 (1997)).
- 33 *See, e.g.,* Eric Blumenson & Eva Nilsen, “Policing for Profit: the Drug War’s Hidden Economic Agenda,” 65 U. CHI. L. REV. 35, 44-45 (1998) (describing the evolution of the DOJ’s asset forfeiture authority).

- 34 U.S. GAO, GAO-12-736, JUSTICE ASSETS FORFEITURE FUND: TRANSPARENCY OF BALANCES AND CONTROLS OVER EQUITABLE SHARING SHOULD BE IMPROVED, at 11 (2012) *available at* <http://www.gao.gov/assets/600/592349.pdf>.
- 35 *Id.*
- 36 *Id.* at 2.
- 37 *Id.*
- 38 *See* Blumenson & Nilsen, *supra* n. 33 at 66.
- 39 *Id.* at 55.
- 40 *See* Robert O’Harrow, Jr., Sari Horowitz, and Steven Rich, “Holder limits seized-asset sharing process that split billions with local, state police,” *Washington Post* (Jan. 16, 2015), *available at* [http://www.washingtonpost.com/investigations holder-ends-seized-asset-sharing-process-that-split-billions-with-local-state-police/2015/01/16/0e7ca058-99d4-11e4-bcfb-059ec7a93ddc_story.html](http://www.washingtonpost.com/investigations	holder-ends-seized-asset-sharing-process-that-split-billions-with-local-state-police/2015/01/16/0e7ca058-99d4-11e4-bcfb-059ec7a93ddc_story.html).
- 41 *Id.*
- 42 *Id.*
- 43 *Id.*
- 44 PBS News Hour, “Will federal reforms on civil forfeiture mean more police accountability?” (Jan. 16, 2015), *available at* <http://www.pbs.org/newshour/bb/will-federal-reforms-civil-forfeiture-mean-police-accountability/>.
- 45 *See* 28 U.S.C. § 527 note; *see also, e.g.*, U.S. Attorneys’ Office, Northern District of Oklahoma, “Civil Division” (“three percent of the dollars recovered from civil judgments are deposited into a special Department of Justice fund which is used to purchase the physical resources needed to support future collection efforts by the Financial Litigation Units in all U.S. Attorney offices”), *available at* <http://www.justice.gov/usao/okn/civil.html>. That revenue “opportunity” provides the same skewed incentives for abuse of prosecutorial authority.
- 46 *See, e.g.*, James E. McCarthy & Claudia Copeland, “EPA Regulations: Too Much, Too Little, or On Track?” Congressional Research Service Report (July 8, 2014) (“Many, both within Congress and outside of it, have accused the agency of reaching beyond the authority given it by Congress and ignoring or underestimating the costs and economic impacts of proposed and promulgated rules. The House has conducted vigorous oversight of the agency in the 112th and 113th Congresses, and has approved several bills that would overturn specific regulations or limit the agency’s authority. Particular attention has been paid to the Clean Air Act; congressional scrutiny has focused as well on other environmental statutes and regulations implemented by EPA.”), *available at* <http://fas.org/sgp/crs/misc/R41561.pdf>.
- 47 EPA, Enforcement Annual Results for Fiscal Year 2012, *available at* <http://www2.epa.gov/enforcement/enforcement-annual-results-fiscal-year-2012>.
- 48 42 U.S.C. § 9601 *et seq.*
- 49 *See, e.g.*, 42 U.S.C. § 9622 (b)(3) (describing the retention of funds garnered by settlement agreements, saying: “If, as part of any agreement, the President will be carrying out any action and the parties will be paying amounts to the President, the President may, notwithstanding any other provision of law, retain and use such amounts for purposes of carrying out the agreement.”).
- 50 *See In re Tronox*, Case No. 09-10155, Dkt. No 635, Settlement Agreement (S.D.N.Y., April 3, 2014), *available at* <http://www2.epa.gov/sites/production/files/2014-04/documents/fraud-settlement-kerrmcgee-tronox.pdf>.
- 51 EPA, “Case Summary: Settlement Agreement in Anadarko Fraud Case Results in Billions for Environmental Cleanups Across the Country” (2014), *available at* <http://www2.epa.gov/enforcement/case-summary-settlement-agreement-anadarko-fraud-case-results-billions-environmental#overview>.
- 52 *Id.*
- 53 *See* Paul J. Larkin, “Funding Favored Sons and Daughters: Nonprosecution Agreements and ‘Extraordinary Restitution,’” 47 *LOY. L. REV.* 1, 6 (2013).
- 54 *Id.*
- 55 *Id.* at 5.
- 56 *Id.* at 8.

- 57 See Letter from Peter J. Kadzik, Ass't Att'y Gen'l, to Bob Goodlatte, Chairman, H. Comm. on the Judiciary, & Jeb Hensarling, Chairman, H. Comm. on Financial Servs. (Jan. 6, 2015); see also Statement of Honorable Bob Goodlatte (Feb. 12, 2015), available at http://judiciary.house.gov/index.cfm/hearings?Id=54921679-400A-40C3-854D-4B7574364D61&Statement_id=BDEB0AAA-3EF1-482F-A403-8D28CDE00ECF.
- 58 See Jann Swanson, "Foreclosure Review Payouts Coming Under Congressional, Media Scrutiny," Mortgage News Daily (May 2, 2013) ("Congressman Elijah E. Cummings recently introduced a bill that would create an independent monitor to oversee the distribution of funds paid by mortgage services to borrowers to compensate for illegal foreclosures and other abuses. The bill, HR 1706, The Mortgage Settlement Monitoring Act of 2013, was crafted by Cummings, Ranking Member of the House Committee on Oversight and Government Reform, because of what he views as a lack of transparency and accountability on the part of federal regulators, banks and their servicing subsidiaries."), available at http://www.mortgagenewsdaily.com/05022013_independent_foreclosure_review.asp.
- 59 See Larkin, *supra* n. 53 at 6-7.
- 60 *Id.*
- 61 See Juliet Elperin, "BP Settlement a Boon to Conservation Group," Washington Post (Nov. 16, 2012), available at http://www.washingtonpost.com/national/health-science/bp-settlement-a-boon-to-conservation-group/2012/11/16/ddcb2790-302b-11e2-a30e-5ca76eeec857_story.html.
- 62 *Id.*
- 63 News Release, U.S. Attorney's Office (D. Conn.), "OMI and U.S. Enter into Deferred Prosecution Agreement" (Feb. 8, 2006), available at www.usdoj.gov/usao/ct/press2006/20060208.html.
- 64 *Id.*

Undoing Checks and Balances: State Attorneys General and Settlement Slush Funds

Under all constitutional governments recognizing three distinct and independent magistracies, the control of the purse strings of government is a legislative function; indeed, it is the supreme legislative prerogative, indispensable to the independence and integrity of the legislature, and not to be surrendered or abridged, save by the constitution itself, without disturbing the balance of the system and endangering the liberties of the people. The right of the legislature to control the public treasury, to determine the sources from which the public revenues shall be derived and the objects upon which they shall be expended, to dictate the time, the manner, and the means both of their collection and disbursement is firmly and inexpugnably established in our political system.¹

One of the more troubling areas of concern in civil litigation is the frequency with which state attorneys general (AGs) are steering public money generated from litigation settlements to their own pet projects or preferred charities and non-profits. This continued practice reflects an aggrandizement of the power of AGs, in

derogation of fundamental separation-of-powers principles enshrined in state constitutions. In particular, while most state constitutions explicitly cabin the power of the purse within the state legislatures, some AGs are ignoring these constitutional provisions by funneling public settlement money into their preferred programs or

individual office budgets absent legislative approval. To be sure, the money is sometimes used for socially valuable purposes. But the process by which that is happening contravenes the public interest. Money recovered in the name of the state belongs to the state and its people, and the authority to decide how to spend that money is vested exclusively in the peoples' representatives in the state legislatures. When AGs keep the money or divert it to third parties, the AGs assume for themselves the right to decide how the state's money is spent, violating the separation of powers, diminishing the state's revenues, and forcing cash-strapped legislatures to make up for the shortfall by either raising taxes or abandoning or postponing legislative priorities.

This continued practice also threatens to undermine the even-handed, principled administration of justice. After all, in most states, the attorney general is elected,² and the position is often a springboard to the state's governorship or other elective office.³ As a result, decisions by a state attorney general about how to allocate state settlement money may be influenced by the AG's personal political aspirations. Indeed, those aspirations may even influence an AG's judgment about what enforcement actions to pursue. For instance, when confronted with an allegedly illegal practice, an AG who is eyeing a run for governor may forgo seeking injunctive relief and instead pursue a cash settlement in order to create a popular program or donate money to a particular organization that might attract votes. Thus, not only does the use of public settlement funds by AGs contravene well-established constitutional and legal principles, but it also raises the possibility

that public dollars will be spent, at least in part, to further the political agendas of state AGs (on both sides of the political spectrum).

The first part of this paper chronicles some examples of state AGs usurping the power of state legislatures by spending public settlement money. The second part of this paper explains why this practice should be reined in, with a particular focus on the separation of powers and other legal and ethical issues implicated by this practice.

“ [N]ot only does the use of public settlement funds by AGs contravene well-established constitutional and legal principles, but it also raises the possibility that public dollars will be spent, at least in part, to further the political agendas of state AGs (on both sides of the political spectrum). ”

Growing Concern Over State AG “Slush Fund” Settlements

Although the practice of state AGs directing the use of settlement funds can be traced back over the last two decades, it is only recently that concern over this practice has bubbled to the surface, raising important questions about separation of powers and conflicts of interest.

Below, we describe some of the better-known examples of this phenomenon and criticism it has garnered. Because the first four cases were the most highly publicized and involved the greatest public outcry, they are addressed in greater detail than the remaining examples.

Michigan Countrywide Settlement

On October 6, 2008, Michigan Attorney General Mike Cox announced a settlement between the State of Michigan and Countrywide Financial related to allegations of questionable lending practices, including misleading marketing techniques and incentives for selling risky loans.⁴ One of the terms of the settlement was that Countrywide would pay approximately \$9.9 million to assist Michigan homeowners who lost their homes to foreclosure and to fund “borrower education programs and neighborhood rehabilitation efforts.”⁵ Of the \$9.9 million, \$6.7 million—or \$1,800 each—would be distributed to 3,700 former Countrywide customers.⁶

Attorney General Cox originally planned to donate \$250,000 each to two Grand Rapids-area parks, including Kent County’s Millennium Park.⁷ According to the press, Cox reached the decision to award the money to Millennium Park after a conversation with a prominent local citizen and chief fundraiser for the park. Cox chose to donate settlement money to the other park, Crescent Park, after speaking to a group of local philanthropists who had raised money for other high-profile public projects.⁸ “Cox defended the gifts, saying they would help stabilize their surrounding neighborhoods.”⁹ In addition to steering settlement money to the two parks, Cox also announced that \$250,000 of the settlement funds would be given to several organizations tackling the foreclosure crisis in the City of Grand Rapids, including Home Repair Services, the Inner City Christian Federation, and the Grand Rapids Urban League.¹⁰

Public and legislative outcry over the use of the settlement money for the parks was

immediate, with the controversy ultimately reaching the Senate floor on March 19, 2009. Both state and local officials contended that the money should have been used to help families who lost their homes to foreclosure.¹¹ Michigan Senate Democrats called for “legislative oversight of settlements won by the Attorney General’s office.”¹² Senator Gretchen Whitmer even accused Cox of using the settlement funds as “his own personal slush fund” to “pad his campaign for higher office.”¹³ Senator Glenn Anderson offered an amendment in the General Government Appropriations Subcommittee to bar the attorney general from designating the settlement proceeds in this manner. Under that proposal, all proceeds of settlements secured by the attorney general would be deposited into the Michigan General Fund “so that the Legislature has some sort of oversight and input as to how the resources are used.”¹⁴ The amendment failed on a party-line vote.¹⁵ Senator Whitmer suggested an alternative solution—i.e., requiring that settlement money go through a grant-type process to guard against “political kickback”; or requiring that the AG send a quarterly accounting of all settlement proceeds to the General Government budget committees in the House and the Senate with a report on the selection process and protocol for determining how funds are distributed.¹⁶

As a result of this controversy, Cox ultimately changed his position on the allocation of the settlement funds. Instead of donating the \$500,000 to the two parks, he decided to donate that money to the Heart of West Michigan United Way.¹⁷ While Cox’s last-ditch change quelled the public criticism prompted by his initial decision, it did nothing to enhance the

transparency or accountability of the process. Indeed, the AG gave no rationale for donating the money to the United Way other than his belief that it is an “unimpeachable organization.”¹⁸ The debate illustrates the political implications of discretionary apportionment of settlement funds by state AGs. And as Senator Whitmer pointed out, the timing of the move—with AG Cox’s anticipated run for the governor’s office in 2010¹⁹—created at least the appearance of improperly using state funds to “pad” his campaign.

Kentucky Vioxx and Avandia Settlements

In January 2014, Kentucky Attorney General Jack Conway announced that more than \$32 million collected from lawsuit settlements with two drug companies, Merck Sharp & Dohme Corporation (Merck) and GlaxoSmithKline (GSK), would be used to expand substance-abuse treatment centers.²⁰ The suits at issue alleged that the two companies had failed to disclose alleged cardiovascular risks of certain medications (Vioxx and Avandia, respectively).

The settlement agreement in the *Vioxx* case provided that:

Any funds distributed by the Attorney General shall be used for purposes designed and intended to investigate, prevent and enforce violations of the [Kentucky Consumer Protection Act (KCPA)]; to ameliorate the consequences of violations of KCPA, including, but not limited to, through public health initiatives, educational or safety campaigns, reimbursement or financing of health care services and infrastructure related to addiction prevention and treatment, and preparation and dissemination of

independent materials and programming aimed at rectifying or mitigating harm, or potential harm, to the citizens of the Commonwealth; or for the Commonwealth's costs resulting from any of the above.²¹

The Kentucky AG intends to divide the funds among a variety of drug treatment programs, including: \$19 million to start a grant program, KY Kids Recovery, to finance juvenile abuse treatment programs; \$2.52 million for scholarships to seek treatment at the state's pre-existing Recovery Kentucky Centers; \$560,000 to help create 14 drug-free homes for people making the transition out of residential drug treatment programs; \$500,000 to complete construction of a treatment center in Ashland, Kentucky; \$6 million to administer KASPER, the state's electronic prescription drug monitoring program; \$1 million to support drug programs for pregnant women; \$1.5 million to the University of Kentucky to assist treatment providers; \$1 million for a school-based substance abuse screening tool with the state Department of Education; and \$250,000 to create a database to evaluate outcomes of juvenile treatment.²²

The AG's announcement was made during a news conference with Governor Steve Beshear, the First Lady, and House Speaker Greg Stumbo. On January 6, 2014, Governor Beshear issued an Executive Order creating the Substance Abuse Treatment Advisory Committee to oversee spending of the settlement money, a committee that will be chaired by the Attorney General.²³ The Committee also includes the First Lady; Cabinet for Health and Family Services Secretary Audrey Tayse Haynes; Justice and Public Safety Secretary J. Michael Brown; Kentucky Office of Drug Control Policy Director Van Ingram; Kentucky Housing

Corporation Executive Director/CEO J. Kathryn Peters; and Dr. Allen Brenzel, Clinical Director of the Department for Behavioral Health, Development and Intellectual Disabilities.²⁴ Additional appointments may be made by Senate President Stivers and Speaker Stumbo to serve as ex-officio committee members.²⁵

While the AG's decision garnered the support of some members of the state legislature, other members have cried foul. Senate President Robert Stivers, in particular, has expressed concern and disapproval that the funds from the settlement were not placed in the state's General Fund so that lawmakers could determine how best to apportion the

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money and noted that the AG's actions circumvented state laws providing for the disposition of settlement funds.²⁶ Stivers did not object to the purposes for which the money was being used; rather, he was concerned about the legality of the process: "My questions are about the process and the process only."²⁷ Stivers reported that he had discussions with Governor Beshear in late 2013 regarding how the money may be used, and shared his concerns with the Governor and AG Conway that "this was an appropriation."²⁸ Stivers told the press that he has no plans to legally challenge the use of the funds by AG Conway in court or through legislation.²⁹ The Attorney General has repeatedly claimed that the use of the settlement funds would withstand any legal challenge.³⁰

Arkansas Activia/DanActive Settlements

On December 15, 2010, Arkansas Attorney General Dustin McDaniel and other attorneys general filed a settlement agreement with The Dannon Company, Inc. to settle false advertising claims involving the sale of Activia and DanActive products. Arkansas's share of the \$21 million settlement was \$425,000. In April of 2011, Attorney General McDaniel announced that three Arkansas hunger-relief organizations—the Arkansas Foodbank, Arkansas Hunger Relief Alliance, and Arkansas Rice Depot—would receive a share of the \$425,000 settlement (\$141,666 each). "Because of the nature of the suit, McDaniel said it makes sense for hunger relief organizations to receive shares of the settlement."³¹

The AG's action was widely criticized. In denouncing McDaniel's use of the funds,

Lieutenant Governor Mark Darr stated, "Great charity, great thing to do, but I question the ethics on that because I think that if I were to do that it would look like I was trying to buy some votes."³² Darr stressed that lawmakers should have the power to decide where such money goes. Aaron Sadler, a spokesman for Attorney General McDaniel, responded that the state's "food insecurity is the most severe in the nation" and McDaniel "took that problem head-on with the Dannon case and the distribution of settlement funds to food banks that serve all 75 counties. [Lt. Gov. Darr's] inappropriate comment shows an unfortunate lack of understanding of the responsibilities of the attorney general's office."³³

The Activia/DanActive settlement was not the first instance in which AG McDaniel spent public settlement money without legislative approval. Prior to that settlement, he already had a long history of unilaterally distributing public funds outside the legislative appropriations process.³⁴ But the Activia/DanActive settlement might have garnered additional scrutiny because the AG was considering higher elective office at the time.³⁵

The AG's actions ultimately prompted calls for legislative oversight. Specifically, Representative Jane English and Senator Cecile Bledsoe proposed House Bill 1046 in February of 2011, which would have required spending from AG settlements and judgments to be authorized by the legislature. Though the bill died in chamber, it was recommended for study in the Joint Interim Committee on State Agencies and Governmental Affairs.³⁶ Finally, in October 2011, the office of the Attorney General announced a new internal policy on lawsuit settlement funds. Signed by AG McDaniel on

October 11, 2011, the policy provides that in the event of a judgment or settlement, the funds shall be distributed in the following manner: (1) payment to Arkansas consumers or state agencies as designated by the court order or settlement agreement; (2) payment to a state agency having a nexus to the underlying litigation; (3) payment of attorney's fees to the State Treasury; or (4) payment into the "Consumer Education and Enforcement Account."³⁷ The policy further specifies that the office of the Attorney General shall retain no more than \$1 million in the "Consumer Education and Enforcement" account to support litigation, investigations and education.³⁸ Funds received pursuant to a judgment or settlement must be distributed by the AG within 120 days of receipt, and the AG will provide quarterly financial reports to the Legislative Council as to all expenditures made pursuant to this policy.³⁹ This policy was codified by the state legislature on August 16, 2013.⁴⁰

Mississippi Tobacco Settlement

One of the earliest examples of an AG invading the sphere of legislative authority with respect to public settlement dollars occurred in Mississippi in the wake of that state's tobacco settlement. Mississippi Attorney General Mike Moore sued various tobacco companies in 1994, culminating in a comprehensive settlement in October 1997.⁴¹ The settlement provided that an initial lump-sum payment of \$170 million was to be paid into a special escrow account "for the benefit of the State of Mississippi."⁴² The settlement also provided for annual settlement payments to the State of Mississippi in perpetuity on an annual basis. And the settlement further established a two-year pilot program "aimed specifically at

the reduction of the use of Tobacco Products by children under the age of 18 years" that was to be funded by a separate, lump-sum payment of \$61.8 million for the benefit of the State of Mississippi.⁴³ The settlement specified that the pilot program "shall last for a 24-month period" and that "no expenditure from the Pilot Program Amount shall be made except upon application to the chancery court by the Attorney General and approval of such application by the chancery court."⁴⁴ In June 1998, the Partnership for a Healthy Mississippi, a private, nonprofit entity, was created, and the chancery court entered an order approving the Mississippi Tobacco Pilot Program, to be administered through the Partnership. The Partnership received the lump sum of \$61.8 million from the defendants.⁴⁵

On February 6, 1998, the Jackson County Chancery Court entered an order directing a transfer of the \$170 million "to the State of Mississippi"; on the motion of the Attorney General, the funds were "deposited in the

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State Treasury into a special fund and invested as a lump-sum by the State Treasurer ... until such time as appropriated or transferred by the State Legislature.”⁴⁶ In March 1999, the Mississippi Legislature created the Mississippi Health Care Trust Fund (MHCTF) in the State Treasury through the enactment of Miss. Code Ann. §§ 43-13-401 through 409, providing that the funds received by the State from tobacco companies would be applied toward improving the healthcare of the citizens and residents of the states, and outlining the manner and means necessary to carry out that purpose.⁴⁷ The statute directed that \$280 million of the settlement funds and all future installments be deposited into the MHCTF.⁴⁸ The statute states that the Legislature shall appropriate funds from the MHCTF as necessary.⁴⁹

From March 30, 1998, until December 22, 2000, all of the proceeds from the Mississippi tobacco settlement were deposited into the MHCTF.⁵⁰ But on December 22, 2000, the chancery court ordered that \$20 million per year be taken from the annual tobacco settlement payments and deposited into the Partnership account.⁵¹ This order was made on an *ex parte* motion by the Attorney General at the time.⁵² In November 2003, the Joint Committee on Performance Evaluation and Expenditure Review of the Mississippi Legislature issued a report finding that the order of the court was not in compliance with state law, as “it is a well-understood principle in Mississippi constitutional law that the Legislature appropriates funds and that this power is exclusive to the Legislature,” and recommending that the Attorney General seek dissolution of the order.⁵³ No action was taken by the Attorney General, and in February 2005, Haley Barbour, Governor of

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the State of Mississippi, sought to vacate the chancery court’s December 22, 2000 order. The Partnership, Division of Medicaid and MHCTF all intervened in the suit.⁵⁴

The chancery court vacated the original order, and the Mississippi Supreme Court affirmed. Looking to the language of the settlement, the court noted that the agreement only provided for the funding of the pilot program for 24 months.⁵⁵ Without agreement between the Executive and Legislative branches of state government or specific legislation

authorizing the funding of the Partnership, the chancery court was without the authority to grant the AG's unilateral motion and continue funding the Partnership pursuant to the December 2000 order.⁵⁶

Michigan, Kentucky, Arkansas, and Mississippi are not anomalous. Numerous other examples of these sorts of "slush fund" settlements abound, including:

TJX COMPANIES, INC.

In 2009, TJX, operator of retailer TJ Maxx, and 41 state AGs entered into a \$9.75 million settlement to resolve claims stemming from TJX's alleged inadequate data security practices that resulted in a massive data breach in 2007.⁵⁷ In addition to paying money to the states, the company agreed to implement and maintain a comprehensive information security program that would safeguard consumer data and address any weaknesses in TJX's systems that led to the 2007 data breach. As part of the settlement, TJX paid the states \$2.5 million to create a Data Security Trust Fund.⁵⁸

This fund is used by the settling state AGs to advance enforcement efforts and policy development in the data security field, and to educate businesses and consumers about protecting personal information.⁵⁹ Under the terms of the settlement, the fund is "to be distributed as designated by and in the sole discretion of the Attorneys General[.]"⁶⁰ The settlement does not require the moneys to be deposited in the states' general funds, and no provision is made for legislative oversight or appropriations.

MONEYGRAM PAYMENT SERVICES

In 2008, MoneyGram reached a settlement with the AGs of 44 states and the District of Columbia in connection with alleged fraud-induced wire transfers.⁶¹ As part of the

settlement, MoneyGram agreed, *inter alia*, to circulate monthly anti-fraud e-mails to MoneyGram outlets and to create new training materials for its agents to more strongly address the issue of fraud-induced transfers and provide enhanced training to personnel who work at locations known to have a high level of fraud-induced transfers.⁶² MoneyGram also paid \$1.1 million to fund a national peer-counseling program, overseen and administered by the AARP Foundation. In 2005, AARP launched an outreach campaign through its Fraud Fighter Call Center; the payment from MoneyGram augmented this campaign.⁶³ The settlement earmarked a substantial sum of money that would otherwise be deposited into state treasury funds for AARP, an organization with substantial political influence in light of its large membership and its significant activity in the political arena.⁶⁴

The settlement also provided that MoneyGram would pay \$150,000 to the Executive Committee, which included the States of Arkansas, Illinois, Massachusetts, New Jersey, North Carolina, Ohio, Texas, Vermont, and Washington.⁶⁵ Each state's AG was to have "sole discretion as to how that State's funds are used to the extent that discretion is consistent with the respective State's law."⁶⁶ The settlement thus represents another agreement under which funds need not be deposited in the state's general fund, bypassing the standard legislative appropriations process, and one that raises additional questions by directing some of the recovery to an organization with a significant capacity to influence political fortunes.

CBS RADIO, INC. AND ENTERCOM COMMUNICATIONS CORP.

In a series of separate 2006 settlements with

then-New York AG Eliot Spitzer, CBS, Entercom and EMI Music North America paid \$2 million, \$3.5 million and \$3.75 million, respectively, to fund music education and appreciation programs, distributed through the Rockefeller Philanthropy Advisors, to the New York State Music Fund.⁶⁷ CBS, Entercom and EMI Music North America, among others, had been sued by the AG after an investigation into their alleged practices of soliciting payments from record labels in exchange for playing those labels' songs more frequently. The AG alleged that certain artists benefitted from the supposed scheme, including the Rolling Stones, Coldplay, Norah Jones, and the band Gorillaz. Although the Rockefeller Philanthropy Advisors is a charitable organization, some have criticized the organization as voicing political viewpoints.⁶⁸ Moreover, the settlements were signed in 2006, when AG Spitzer was in the final stretch of his gubernatorial campaign, giving rise to the same possibility suggested in the Michigan and Arkansas examples detailed above that the settlements were intended to "pad" a campaign for political office. It is unclear why the money was not simply distributed to New York's general treasury account, leaving decisions regarding the appropriation of the money to the state legislature.

CITIBANK AND SALLIE MAE

In 2007, Citibank and Sallie Mae entered into separate settlements with then-New York AG Andrew M. Cuomo arising out of alleged conflicts of interest in student loan arrangements between schools and lenders.⁶⁹ As part of the agreements, the companies paid \$2 million each to a fund designed to educate college-bound students and their parents about the student loan industry.⁷⁰ The fund was administered by the New York AG.⁷¹ It appears that the AG had total discretion

over use of the funds paid by the two companies, leaving the state legislature out of the process.

PEARSON CHARITABLE FOUNDATION

In December 2013, the New York AG entered into a \$7.7 million settlement agreement with Pearson Charitable Foundation, a not-for-profit that is affiliated with the for-profit education company Pearson, Inc.⁷² Under the terms of the settlement, the Pearson Charitable Foundation was required to pay \$7.5 million into a fund held by the New York AG's office "to support programs in New York and other states that recruit and retain excellent K-12 teachers and support such teachers in providing high quality instruction aligned to the Common Core State Standards as are

“ Moreover, the settlements were signed in 2006, when AG Spitzer was in the final stretch of his gubernatorial campaign, giving rise to the same possibility suggested in the Michigan and Arkansas examples detailed above that the settlements were intended to ‘pad’ a campaign for political office. ”

selected by [the New York AG's office] among programs identified by 100kin10, an independent, not-for-profit organization."⁷³ The settlement provided that the AG would "administer and pay monies" from the fund.⁷⁴ Thus, like many other AG settlements, the Pearson Charitable Foundation settlement appears to divert money from the state's general fund and bypass the legislative appropriations process.

CARDINAL HEALTH, INC.

In 2006, Cardinal Health Inc. reached an agreement with then-New York AG Eliot Spitzer regarding the alleged improper secondary market trading of pharmaceuticals.⁷⁵ Under the agreement, Cardinal would pay \$7 million to Health Research Inc., a New York not-for-profit corporation affiliated with the New York State Department of Health and the Roswell Park Cancer Institute, and an additional \$3 million to the state of New York.⁷⁶ The settlement is an example of money owed to the state being directed to a preferred charity.

MORGAN STANLEY

In connection with a \$102 million settlement between Massachusetts AG Martha Coakley and Morgan Stanley in 2010, Morgan Stanley agreed to pay \$2 million to various state non-profit groups to assist victims of subprime foreclosure for its alleged role in the securitization and financing of Massachusetts subprime loans.⁷⁷ The terms of the settlement agreement required Morgan Stanley to consult with the Massachusetts AG's office regarding the allocation of the funds, "so that the combination of recipient organizations will provide coverage for consumers located in all sections of [Massachusetts] in relative proportion to the number of foreclosures in those sections[.]"⁷⁸ It also required Morgan

Stanley to make donations "to not-for-profit groups to which the AGO [i.e., Office of the Attorney General] does not object."⁷⁹ It further conditioned the donations on the requirements "that the not-for-profit groups give priority to borrowers referred to them by the AGO for assistance;" "that the not-for-profit groups make available to qualified foreclosed borrowers the types of assistance as the AGO shall recommend;" and "that the not-for-profit groups provide such information and reports to the AGO as the AGO requires regarding the not-for-profit groups' uses of the donation." In Massachusetts, "[t]he attorney general and the district attorneys shall account to the state treasurer for all fees, bills of costs and money received by them by virtue of their offices."⁸⁰ This rule implies that the Massachusetts AG "ha[s] total control of incoming funds with the single limitation of having to 'account' to the treasury."⁸¹ Although this accounting provides for some transparency in the AG's discretionary spending decisions, it does little to prevent an AG from diverting settlement funds to private third parties, even when the AG may be planning a campaign for higher office.⁸²

In sum, a number of AGs across the country have effectively appropriated public settlement money without legislative oversight, a practice that has been relatively ignored because the recipients are usually charitable organizations. But the identity of the recipients is not the primary issue of concern. Rather, lawmakers, courts and commentators should take a close look at whether "slush fund settlements" violate core constitutional principles, implicate conflict-of-interest concerns, and ultimately undermine the public interest.

Spending of Public Money by State AGs Raises Serious Legal and Ethical Issues

As the examples summarized above illustrate, many state AGs appear to believe that they have unfettered discretion to decide how to spend settlement money that belongs to the state. The assertion and exercise of this imagined discretion takes various forms.

In some cases, the funds are retained by an AG to be spent in any manner the AG chooses. In other cases, the AG and the defendant agree on settlement terms that dictate that some or all of the settlement funds will be paid to third parties rather than (or in addition to) the state. Both approaches are problematic for three related reasons

First, the practice of sending settlement money anywhere other than a general fund for the legislature’s disposal violates bedrock separation-of-powers principles. Under both federal and state constitutions, the power to raise and spend the people’s money is vested exclusively in the legislatures, whose members are considered the representatives most accountable to the people and therefore the only ones who should be allowed to spend the people’s money. This exclusive authority serves as an important structural safeguard against executive excess—a safeguard that is transgressed any time the AG spends money belonging to the people, whether the AG does so directly or by diverting funds that would otherwise go to the state

to charities through settlements with alleged violators of state law.

Second, AG expenditure and allocation of funds recovered in enforcement actions also violate a range of state statutory laws adopted precisely to curb or significantly regulate that practice. Notably, several of the incidents described above ran afoul of state laws on the books at the time, suggesting that stronger legislation and oversight is needed in order to rein in abuses.

“ *The practice of sending settlement money anywhere other than a general fund for the legislature’s disposal violates bedrock separation-of-powers principles.* ”

Third, the expenditure and allocation of funds by AGs also pose significant ethical problems. As the Institute for Legal Reform has previously cautioned, AGs must be careful to avoid “financial and business dealings” that “may reflect adversely on their impartiality, interfere with their official duties, or exploit the office.”⁸³

Unfortunately, however, some AGs have sought to funnel settlement funds to popular or politically active nonprofit entities while contemplating or actively undertaking a campaign for higher office.

We explore these principles in greater detail below.

Separation of Powers

One of the hallmarks of American governments is the division of power between the respective branches of government. Dividing power among the executive, legislature and judiciary provides a bulwark against the concentration of power within any one single branch. While this principle permeates both the U.S. Constitution and state constitutions, “[s]tate constitutions ... typically observe separation of powers principles more strictly[.]”⁸⁴ As commonly defined by state constitutions, separation-of-powers provisions require that “[n]o person or collection of persons, being one or belonging to one of these departments [legislative, judicial, and executive], shall exercise any power properly belonging to either of the others.”⁸⁵

One long-recognized separation-of-powers principle is that the authority to raise and spend money is an exclusively legislative power. As early commentary on the Appropriations Clause of the U.S. Constitution⁸⁶ explained, the power is committed to the legislature as the

representative of the people because “it is the right of the people ... to be actually consulted upon the disposal of the money which they have brought into the treasury” in light of the fact that “[a]ll the expenses of government [are] paid by the people.”⁸⁷ As such, the exclusive right of the legislature to spend the people’s money “form[s] a salutary check, not only upon the extravagance, and profusion, in which the executive department might otherwise indulge itself, and its adherents and dependents; but also against any misappropriation, which a rapacious, ambitious, or otherwise unfaithful executive might be disposed to make.”⁸⁸

Thus, not surprisingly, “[n]early every state [constitution] in the Union” specifically vests the power to spend money in the legislative branch of government.⁸⁹ For example, the Michigan Constitution provides that no money shall be paid out of the state treasury “except in pursuance of appropriations made by law.”⁹⁰ Section 230 of the Kentucky Constitution similarly provides that “[n]o money shall be drawn from the State Treasury, except in pursuance of appropriations made by law; and a regular statement and account of the receipts and expenditures of all public money shall be published annually.”⁹¹ The Arkansas Constitution also expressly requires that funds spent on behalf of the state be appropriated, stating that “[n]o money shall be paid out of the treasury until the same shall have been appropriated by law; and then only in accordance with said appropriation.”⁹² Additionally, article XVI, section 3 of the Arkansas Constitution specifically provides a penalty for the misuse of public funds: “The making of profit out of public moneys, or using the same for any purpose not authorized by law,

“ [S]tate supreme courts have ‘long held that the power to appropriate state funds is legislative and is to be exercised only through duly enacted statutes.’ Such a rule ‘secures to the Legislative [branch] ... the exclusive power of deciding how, when, and for what purpose the public funds shall be applied in carrying on the government.’ ”

by any officer of the State, or member or officer of the General Assembly, shall be punishable as may be provided by law, but part of such punishment shall be disqualification to hold office in this State for a period of five years.”⁹³

Consistent with these constitutional provisions, state supreme courts have “long held that the power to appropriate state funds is legislative and is to be exercised only through duly enacted statutes.”⁹⁴ Such a rule “secures to the Legislative [branch] ... the exclusive power of deciding how, when, and for what purpose the public funds shall be applied in carrying on the government.”⁹⁵ As the Mississippi Supreme Court succinctly put it, “the legislative [branch] alone has access to the pockets of the people, and has in some Constitutions full discretion, and in all, a prevailing influence over the pecuniary

awards of those who fill the other departments, a dependence is thus created in the latter.”⁹⁶ Therefore, “[w]ithout question, the expenditure of public funds is appropriately a legislative function.”⁹⁷

As at least two state courts have recognized, these principles bar the AG—a member of the executive branch—from spending moneys belonging to the state that the legislature had not previously appropriated.

In *Hood ex rel. State Tobacco Litigation*,⁹⁸ discussed above, the Mississippi Supreme Court acknowledged the Governor’s attack on the chancery court’s original order allowing the AG to unilaterally transfer state settlement funds as a violation of article I, sections 1-2 of the Mississippi Constitution relating to the separation-of-powers doctrine.⁹⁹ Although the court was careful to state that it was not actually deciding the constitutional question, it nevertheless “note[d] the obvious”—namely, that the “Legislature holds the purse strings.”¹⁰⁰

According to the court:

Under all constitutional governments recognizing three distinct and independent magistracies, the control of the purse strings of government is a legislative function; indeed, it is the supreme legislative prerogative, indispensable to the independence and integrity of the legislature, and not to be surrendered or abridged, save by the constitution itself, without disturbing the balance of the system and endangering the liberties of the people. The right of the legislature to control the public treasury, to determine the sources from which the public revenues shall be derived and the objects upon which they shall be expended, to dictate the time, the manner, and the means both of their collection and disbursement is firmly and inextinguishably

established in our political system.¹⁰¹ The court went on to highlight that “the expenditure of public funds”—i.e., public settlement money—“is appropriately a *legislative* function.”¹⁰² Because the \$20 million given annually to the Partnership was never appropriated, but rather designated as a result of a unilateral *ex parte* motion by the Attorney General, the chancery court was not authorized to grant the order. As the court explained, the “tobacco installment payments are monies that unquestionably belong to the state of Mississippi” and, thus, they should have been placed in the Trust Fund until properly appropriated by the Legislature.¹⁰³

Similar reasoning was applied by the Louisiana Supreme Court in a slightly different context involving the retention of outside counsel. In *Meredith v. Ieyoub*, Louisiana’s highest court voided a series of contingency fee agreements entered into by the AG on the ground that Louisiana’s separation-of-powers doctrine prohibited the AG from entering into contingency fee contracts absent approval by the state legislature.¹⁰⁴ The court’s analysis began with the rudimentary principle, codified in article II, section 2 of the Louisiana Constitution, that “[e]xcept as otherwise provided by this constitution, no one of the[] [three] branches, nor any person holding office in one of them, shall exercise power belonging to either of the others.”¹⁰⁵ Next, the court explained that “[i]t is elementary that the fiscal affairs of the state, the possession, control, administration, and disposition of the property, funds, and revenues of the state, are matters appertaining exclusively to the legislative department.”¹⁰⁶ Because the Louisiana Constitution “vests the power over state finances in the legislative branch as part of its plenary power,” the court reasoned

that the AG could only retain outside counsel if it possessed such authority pursuant to the constitution or statutory law.¹⁰⁷

According to the court, while the constitution authorized the AG to initiate lawsuits and appoint assistant attorneys, it did not authorize him to “pay” outside attorneys to prosecute those actions.¹⁰⁸ Similarly, the court found no statutory law authorizing such action by the AG.¹⁰⁹ Therefore, because the Louisiana legislature has the sole constitutional authority to apportion funds, and a contingency fee contract involving the state and outside counsel is an expenditure of state funds that must be approved by the legislature, the Louisiana Supreme Court invalidated the contract as a violation of the state constitution.

The reasoning of these decisions—and particularly *Hood*, which dealt directly with an AG’s attempt to in effect appropriate settlement funds for his own purposes—has a clear implication: Funds paid in settlement of enforcement claims brought in the name of the state belong to the state and the people, and as such cannot be diverted by AGs away from the state’s general fund (at least absent legislation authorizing such diversions). The principle is equally applicable whether the AG diverts the money to an office slush fund for later discretionary spending by the AG or instead diverts it to a private third party. After all, funds recovered in the name of the state belong to the state, regardless of whether that money arrives at the AG’s office in the form of cash or instead is paid to another party.¹¹⁰ And as a practical matter, the diversion of settlement moneys to any destination other than the general fund has the same effect: It deprives the state of general revenue it otherwise would have had, leaving the people either to make up the difference by paying more taxes or to

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abandon or delay legislative priorities until more money becomes available.

Moreover, an AG’s expenditure or allocation of settlement funds in enforcement disputes gives rise to the very concerns that animated the decision long ago to commit appropriations powers to the representative branch of government. In diverting the state’s money away from the general fund, an AG violates “the right of the people ... to be actually consulted upon the disposal” of their money.¹¹¹ And an AG who bypasses the appropriations process and uses

settlement funds to expand the power of the AG’s office or to pursue greater political fortunes “indulge[s]” in the very “extravagance, and profusion” that the commitment of appropriations discretion to the legislature was intended to guard against.¹¹² Indeed, the political backlash that unfolded in Michigan, Arkansas, and elsewhere in response to unilateral efforts by AGs to spend settlement funds rather than turn them over to the general fund reflects the continued vitality of these principles and their incompatibility with AG discretion to spend unappropriated funds.¹¹³

In short, in many states, an AG’s use of settlement funds for the AG’s office or for the enrichment of private third parties improperly assumes a legislative prerogative and violates the constitutionally mandated separation of powers.

Statutory Law

In addition to constitutional proscriptions, a number of states have adopted statutes that explicitly bar AGs from doing anything with funds derived from settlements other than deposit them directly into the state treasury. Indeed, as elaborated in greater detail below, Michigan, Kentucky, Arkansas, Mississippi, and New York, five states that were each involved in at least one settlement discussed above, fall within this category.¹¹⁴

MICHIGAN

Since 1997, Michigan law has required that “[a]ll moneys received by the attorney general, for debts due, or penalties forfeited to the people of this state, shall be paid by him or her, immediately after receipt, into the state treasury.”¹¹⁵ The statute goes on to state that “[e]xcept as otherwise provided in this section, any proceeds from a lawsuit settlement entered into by a state agency ... as the result of an action instituted on behalf

of the state against a private individual or business ... shall be deposited into a restricted fund to be used as provided by law.”¹¹⁶

By its terms, the statute appears to expressly bar AG Cox’s decision to divert Countrywide settlement moneys from the state’s treasury to private third parties. After all, the *Countrywide* suit plainly involved “an action instituted on behalf of the state against a private individual or business”; and that action was also clearly one for “debts due, or penalties [to be] forfeited to the people of” Michigan.¹¹⁷ Conceivably, the AG might respond that the amounts designated for charity were not “moneys received by the attorney general,” but such a reading would defeat the facially apparent purpose of the act to direct the full value of all recoveries to the state’s general fund. In any event, the political controversy that followed AG Cox’s actions was not anchored in the statute and thus generated no debate over its scope or application to the AG’s activities. As such, it remains to be seen whether the statute can serve as an effective check on AGs who attempt to designate funds for particular purposes in settling enforcement disputes.

KENTUCKY

Section 48.005 of the Kentucky Revised Statutes Annotated addresses public accountability for funds or assets recovered by duly elected statewide constitutional officers through judgment or settlement.¹¹⁸ It provides that the power to appropriate funds for public purposes is “solely within the purview of the legislative branch of government.”¹¹⁹ The statute states that “[a]ccountability for assets or funds recovered by duly elected statewide constitutional officers is essential to the public trust, and is even more critical when that officer was a party to the action that resulted in the

recovery by virtue of the public office he or she holds.”¹²⁰ The law goes on to specify that “[w]henver the Attorney General ... is a party to or has entered his appearance in, a legal action on behalf of the Commonwealth of Kentucky, including ex rel. or other type actions, and a disposition of that action has resulted in the recovery of funds or assets to be held in trust by the Attorney General ... or by a person, organization, or entity created by the Attorney General, or the Commonwealth, through court action or otherwise, to administer the trust funds or assets, for charitable, eleemosynary, benevolent, educational, or similar public purposes, those funds shall be deposited in the State Treasury and the funds or assets administered or disbursed by the Office of the Controller.”¹²¹ The law also provides for the recovery of reasonable costs of litigation by the Office of the Attorney General, after which “[a]ll remaining funds shall be deposited in the general fund surplus account.”¹²² Section 48.700 governs the general fund surplus account, and states that “[n]o expenditures shall be made from this account unless appropriated by the General Assembly....”¹²³

Once again, it appears that current practice does not align with clear statutory requirements in every case. Although usually “[m]oney from legal settlements obtained by the [Kentucky] attorney general” is “put in the state’s General Fund” and “[s]tate legislators then determine how the money is spent,”¹²⁴ the recent Vioxx and Avandia settlements depart from this statutorily-mandated norm. As discussed above, these settlements purport to allocate funds to drug treatment programs—as well as to the AG himself, for “purposes designed and intended to investigate, prevent and enforce violations of the” Kentucky Consumer Protection Act.¹²⁵ The negative reaction to

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this approach by some state legislators makes perfect sense. An AG siphoning settlement funds to his own coffers and diverting other funds to third parties contravenes the law requiring that funds recovered in an action brought on behalf of the state “be deposited in the State Treasury and the funds or assets administered or disbursed by the Office of the Controller.”¹²⁶

ARKANSAS

At all times relevant to AG McDaniel’s use of public settlement funds, Arkansas law presumed that moneys from “[a]ll matters pertaining to the duties of the Attorney General when money belonging to the state is to be collected” would be deposited into the state treasury and expressly mandated that most civil penalties also be deposited there.¹²⁷ In the wake of public outcry over AG McDaniel’s expenditure of public settlement money, the AG ultimately changed his office’s internal policies, which in turn were ultimately codified into law. Whenever the state receives a portion of a settlement or judgment

from an action to which the state is a party, the AG must distribute the money in the following manner: (1) payment to Arkansas consumers or state agencies as designated by a court order or settlement agreement; (2) payment to a state agency having a nexus to the underlying litigation; (3) payment of attorney’s fees to the State Treasury, or (4) payment into the “Consumer Education and Enforcement Account.”¹²⁸

MISSISSIPPI

Mississippi statutory law also requires the state AG to turn over all funds received from a settlement. According to that state’s law, the AG “shall account for and pay over to the proper officer all moneys which may come into his possession belonging to the state or any subdivision thereof.”¹²⁹ In a pair of cases in 2012, the Mississippi Supreme Court interpreted a different law that explicitly requires outside counsel to be paid only out of a legislative appropriation. In those cases, the Mississippi Supreme Court held that state law prohibited the AG from authorizing payment of contingency fees upon the settlement of the underlying cases because state law restricts the compensation of outside counsel to amounts appropriated by the legislature.¹³⁰ The same rationale would presumably invalidate attempts by the AG to spend public settlement money, as there is a similar law on the books requiring him or her to turn over all money received. The AG’s decision to bypass the legislative appropriation process culminated in the enactment of the Mississippi Sunshine Act, which increased the transparency of arrangements between the AG and outside counsel and imposed additional limits on the use of contingency fee counsel.

NEW YORK

Under New York law, money received for or on behalf of the state must be deposited into the state treasury pursuant to State Finance Law § 121(1).¹³¹ New York law also requires that money paid out of the treasury be paid only pursuant to the legislative appropriation process.¹³² The provision of New York law dealing specifically with the powers of the AG confirms that this rule applies to money received by the AG. Specifically, according to New York Executive Law, the AG must “pay into the treasury all moneys received by him for debts due or penalties forfeited to the people of the state.”¹³³ Although the Executive Law goes on to authorize the recovery of costs by the AG, it does not purport to change the default rule that money received must generally be deposited into the state treasury.¹³⁴

Nevertheless, the New York AG’s practice has departed in several instances from the statutory requirements. In every one of the CBS Radio, Entercom Communications, Citibank, Sallie Mae, Pearson Charitable Foundation, and Cardinal Health settlements, funds in the amount of millions of dollars were paid either to private third parties or into a fund to be managed by the AG—not the legislature. It is difficult to reconcile any of these arrangements with the express requirement that the AG “pay into the treasury all moneys received by him for debts due or penalties forfeited to the people of the state.”¹³⁵

The states highlighted above are just a sample of those whose laws require AGs receiving money from settlements and judgments to deposit the money into the state treasury. These laws simply reinforce the constitutional principle reflected in most state constitutions that the legislature reigns supreme in financial matters. Codifying this principle in a state’s

code makes clear that, absent some legislatively-prescribed revolving fund administered by the AG, money received by state AGs, including settlement funds, belongs to the state and can only be spent by the legislature pursuant to the legislative appropriation process.

Ethical Issues

The continued retention and diversion of state settlement money by AGs also raises serious ethical concerns. In particular, allowing the AG to claim discretion to keep or assign recoveries in litigation brought on the state’s behalf creates an incentive for AGs to use their offices to help potential political allies within and outside the government and thereby promote their own career agendas. And regardless of the AG’s political aspirations, allowing an AG’s office to retain the funds it recovers rather than turn them over to a general fund also creates an incentive to pursue potentially lucrative cases first—even when those cases may be marginal on the merits and may trade off with the pursuit of more meritorious but less glamorous cases. At a minimum, that incentive, even if it never actually exerts any undue influence on the AG’s agenda, gives rise to a troubling appearance of impropriety.

First, the discretionary use of public settlement money by state AGs creates the potential for conflicts of interest between an AG’s fiduciary responsibilities as a public officer and the AG’s political aspirations. As explored in detail, several AGs have spearheaded settlements that directed money toward private and in some cases politically influential organizations at precisely the same time the AGs were either contemplating a run for higher office or actively pursuing that office. In these circumstances, it is impossible to know whether an AG’s decision to donate

public settlement money to a particular park or sign off on a settlement that earmarks public funds for an ideological non-profit was done to further the AG's political aspirations. But it is widely recognized that state AGs are often "governors-in-waiting, eager for public attention,"¹³⁶ and the possibility that they might use the powers of their office to make important political connections cannot be overlooked. All relevant parties—the voters, the political system, and the AGs themselves—would be better served if AGs were to steer clear of settlements that put funds in the pockets of potential political allies to avoid any appearance of impropriety.

Second, the prospect that an AG might be able to keep the funds recovered in an enforcement action—and thereby massively expand the office's operating budget—raises an additional ethical problem: the possibility that money might take the place of the public interest in deciding enforcement priorities. As AGs retain the proceeds of settlements generated from enforcement actions for their own offices or preferred programs instead of depositing the money into state treasury accounts, they acquire a "'private' interest, so to speak – in the outcome of the case."¹³⁷ "Even if the [AG] carefully considers the public interest in the enforcement and continues to weigh all the costs, the conclusion of its cost-benefit analysis may be different given the new interest on the scale," which will auger "in favor of action."¹³⁸ The likely result is increased enforcement activity in some cases where such action may not be in the public interest. This extraneous influence on the decision about which cases to pursue poses a potential threat to the prosecutorial impartiality that is required by due process and, if nothing else, creates an appearance of impropriety by "complicat[ing] th[e] distinction between public and private enforcement."¹³⁹

This appearance of ethical impropriety was acknowledged in statements made by former Connecticut Assistant Attorney General Robert M. Langer in 1988. Langer, who headed the state's antitrust enforcement division, recommended the elimination of the AG revolving fund, which helped finance the AG's office based on proceeds from antitrust judgments and settlements.¹⁴⁰ Langer stated that he

feared that the office could be criticized for appearing to make strategic decisions based solely, or at least primarily, upon financial considerations. Indeed, [he] often received extremely critical comments specifically directed at the fund from opposing counsel during negotiations[.] Whether true or not, the perception that [the Connecticut AG] brought and/or settled cases to fill [the office's] coffers persisted. As a consequence of the potential for skewing [the AG's] priorities, [Langer] recommended the elimination of the revolving fund[, which occurred in 1985].¹⁴¹

Although Langer's statements were made in connection with an antitrust enforcement revolving fund, the sentiments he expressed apply with equal force to the more general practice of spending public settlement money to benefit the AG or his or her office.

In short, state AGs' expenditure of public settlement money raises serious ethical issues. From incentivizing enforcement actions to using public settlement dollars on popular programs that might attract voters in an upcoming election, the practice creates important ethical challenges—challenges that would likely be eliminated or significantly mitigated by restoring the role of the legislature in spending public settlement money.

Conclusion

American companies are increasingly being forced to defend against lawsuits by state AGs. Rather than incur the enormous costs of litigating these suits through trial, the companies often settle—irrespective of the merits of the state’s underlying claims. A persistent tactic by state AGs is to then unilaterally allocate and spend the public money generated from these settlements for projects they deem proper.

While the money is sometimes used for laudable purposes, the AGs are nonetheless circumventing important processes mandated by either state constitutions or state law (or both). In addition, the AGs who are making these allocation decisions are often eyeing higher elective office and may be influenced by their political aspirations, undermining the fair administration of justice. State lawmakers should zealously defend their constitutionally- and statutorily-enshrined prerogatives over fiscal matters.

Although AGs’ expenditure of public settlement dollars has generated some criticism by lawmakers and legal commentators, state legislators have thus far generally stopped short of challenging the practice in court. Given the importance of the separation of powers, statutory and ethical issues raised by state AGs’ expenditure of public settlement funds, state legislators might consider translating their disapproval into legal actions that directly challenge this practice.

“ While the money is sometimes used for laudable purposes, the AGs are nonetheless circumventing important processes mandated by either state constitutions or state law (or both). ”

Endnotes

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- 9 Harger, *supra* note 7.
- 10 Grand Rapids Press, *Countrywide money for parks draws criticism; Secchia defends Millennium donation because of its urban location*, Michigan Live, Mar. 18, 2009, http://www.mlive.com/news/grand-rapids/index.ssf/2009/03/countrywide_money_for_parks_dr.html.
- 11 Harger, *supra* note 7.
- 12 *Id.*
- 13 Grand Rapids Press, *supra* note 8 (internal quotation marks omitted).
- 14 *Id.* (internal quotation marks and citation omitted).
- 15 *Id.*
- 16 See Statement of Senator Gretchen Whitmer, Journal of the Senate, Mar. 19, 2009, at 383, [http://www.legislature.mi.gov/\(S\(2sj042m3x50xjyzqqdmma255\)\)/documents/2009-2010/journal/senate/pdf/2009-SJ-03-19-022.pdf](http://www.legislature.mi.gov/(S(2sj042m3x50xjyzqqdmma255))/documents/2009-2010/journal/senate/pdf/2009-SJ-03-19-022.pdf).
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- 80 Mass. Gen. Laws Ann. ch. 12, § 29.
- 81 Michael D. Weiss, *Actually Shutting Down the Virtual Multistate Corporation*, 28 Ind. L. Rev. 607, 621 (1995); *see also Att'y Gen. v. Tufts*, 132 N.E. 322, 344-45 (Mass. 1921) (the statute "provid[es] that all moneys received by a district attorney by virtue of his office shall be accounted for with the state treasurer").
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- 83 U.S. Chamber Institute for Legal Reform, *State Attorney General Code of Conduct* at 9 (2007).
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- 85 Miss. Const. art. I, § 2; *see also* Ark. Const. art. IV, § 2 ("[n]o person or collection of persons, being of one of these departments [legislative, executive, and judicial], shall exercise any power belonging to either of the others" unless otherwise expressly permitted by the Constitution).
- 86 U.S. Const. art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.").
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- 88 *Id.*
- 89 *Commonwealth v. Lot No. 353 New G*, 2012 MP 6 ¶ 17, 2012 WL 2564303 (N. Mar. 1. 2012) (internal quotation marks and citation omitted); *see also* Little, *supra* note 84, at 1152-53.
- 90 Mich. Const. art. IX, § 17. The New York Constitution uses virtually identical language. N.Y. Const. art. VII, § 7.
- 91 Ky. Const. § 230.
- 92 Ark. Const. art. XVI, § 12.
- 93 *Id.* art. XVI, § 3.
- 94 *Chiles v. Children A, B, C, D, E, & F*, 589 So. 2d 260, 265 (Fla. 1991); *see also Meredith v. Ieyoub*, 700 So. 2d 478, 481 (La. 1997) ("[T]he legislature has control over the finances of the state, except as limited by constitutional provisions.") (citation omitted).
- 95 *Chiles*, 589 So. 2d at 265; *see also Hunter v. State*, 865 A.2d 381, 390 (Vt. 2004) ("[W]e recognize that appropriations necessarily represent legislative determinations of policy, by deciding which programs and activities to support financially and therefore who obtains intended public benefits.").
- 96 *Hood ex rel. State Tobacco Litigation Hood*, 958 So. 2d 790, 812-13 (Miss. 2007) (internal quotation marks and citation omitted).

- 97 *Id.* at 813; *see also* Little, *supra* note 84, at 1152 (“This requirement that all funds belong to the state and must be deposited in the treasury is one of two complementary governing principles implicit in our state and federal constitutional order, the other being the prohibition of any expenditure of any public money without legislative authorization.”).
- 98 958 So. 2d at 795.
- 99 *Hood*, 958 So. 2d at 812 (“No person or collection of persons, being one or belonging to one of these departments [legislative, judicial, and executive], shall exercise any power properly belonging to either of the others.”).
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- 101 *Id.* (internal quotation marks and citation omitted).
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- 105 *Id.* at 481 (quoting La. Const. art. II, § 2).
- 106 *Id.* (quoting *State v. Duhe*, 9 So. 2d 517, 521 (La. 1942)) (internal quotation marks and citation omitted).
- 107 *Id.*
- 108 *Id.* at 482.
- 109 *Id.* at 482-83.
- 110 *See* Kate Stith, *Congress’ Power of the Purse*, 97 Yale L.J. 1343, 1356 (1988) (“All funds belonging to the United States – received from whatever source, however obtained, and whether in the form of cash, intangible property, or physical assets – are public monies, subject to public control and accountability.”).
- 111 1 *Blackstone’s Commentaries*, *supra* note 88, at app. 362.
- 112 *Id.*
- 113 *See, e.g.*, Little, *supra* note 84, at 1154 (“If such power were legal, unchecked by legislative appropriations oversight, it would give the attorneys general lawmaking authority and an unconstitutional discretion over the expenditure of state funds.”) (discussing practice of AGs’ retention of contingency fee counsel).
- 114 Some “states have established all-purpose revolving funds for the support of the office of the attorney general, which are funded by the proceeds of any civil litigation conducted by the attorney general and may be used for the performance of any of the powers or duties of the office.” Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement*, 127 Harv. L. Rev. 853, 866-67 & n.63 (2014) (citing Ala. Code § 36-15-4.2 (all civil recoveries); Ohio Rev. Code Ann. § 109.081 (up to eleven percent of any civil recovery)). Other states have established revolving funds for the office of the attorney general financed by the proceeds of antitrust lawsuits or consumer-protection lawsuits. *See* Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. Rev. 698, 735 n.166 (2011). For example, in California, the greater of ten percent of antitrust recoveries plus attorneys’ fees or the actual amount expended is deposited into a revolving fund controlled by the AG. *See* Cal. Bus. & Prof. Code § 16750. California has a similar provision with respect to consumer-protection lawsuits; however, that statute requires appropriation by the legislature. *See* Cal. Bus. & Prof. Code § 17206(c)-(d) (“The portion of penalties that is payable to the General Fund or to the Treasurer recovered by the Attorney General from an action or settlement of a claim made by the Attorney General pursuant to this chapter . . . shall be deposited into this fund. Moneys in this fund, upon **appropriation by the Legislature**, shall be used by the Attorney General to support investigations and prosecutions of California’s consumer protection laws.”) (emphasis added). Similarly, Florida law provides for an AG revolving fund financed by the proceeds of antitrust, consumer-protection and RICO actions. *See* Fla. Stat. § 16.53(1). The special fund remains part of the State Treasury, and the Legislature retains control over it. *See id.* (“There is created in the State Treasury the Legal Affairs Revolving Trust Fund, from which the Legislature **may appropriate funds** for the purpose of funding investigation, prosecution, and enforcement[.]”) (emphasis added); *see also* Nev. Rev. Stat. § 598A.260 (“[a]ll attorney’s fees and costs and 50 percent of all recoveries” in consumer-protection suits are to be deposited into state treasury and then credited to the attorney general’s special fund).
- 115 Mich. Comp. Laws § 14.33(1); *see also*

- Weiss, *supra* note 82, at 614 (recognizing that Michigan requires the AG to turn over all funds to the state treasury).
- 116 Mich. Comp. Laws § 14.33(2).
- 117 The statute was construed in one case where the governor negotiated a settlement and put the funds to a particular use rather than depositing them in the state treasury, but the court determined that the statute was not applicable because the settlement did not result from a state enforcement action and did not involve a “payment of debts or as penalties.” *Tiger Stadium Fan Club, Inc. v. Governor*, 553 N.W.2d 7, 12 (Mich. Ct. App. 1996).
- 118 The statute became effective on April 11, 2012.
- 119 Ky. Rev. Stat. Ann. § 48.005(1)(b) & (d). A similar version of this law was enacted in April 2000. *See* 2000 Ky. Acts 483.
- 120 Ky. Rev. Stat. Ann. § 48.005(1)(b).
- 121 *Id.* § 48.005(3).
- 122 *Id.* § 48.005(4).
- 123 *Id.* § 48.700(8).
- 124 Brammer, *supra* note 20.
- 125 *See* Agreed J. ¶ 28, *supra* note 21; Kemp, *supra* note 20; Brammer, *supra* note 20.
- 126 Ky. Rev. Stat. Ann. § 48.005(3).
- 127 *See* Ark. Code Ann. § 19-2-101(a) (“It shall be the duty of the Secretary of State, the Insurance Commissioner, the Commissioner of State Lands, the Attorney General, the Bank Commissioner, and the Auditor of State to issue their receipts respectively for all moneys coming into the State Treasury through their departments, respectively[.]”); *see also id.* § 20-21-204(b)(7)(A). Arkansas also has a law permitting certain moneys received from civil penalties to be deposited into a special fund called the Elder and Disabled Victims Fund that is administered by the AG. *Id.* § 4-88-202(b).
- 128 *Id.* § 4-88-105. Numerous other states impose similar requirements on their AGs and other state officials. *See, e.g.,* Alaska Stat. § 37.10.060 (“All fees and receipts received by the Department of Revenue from any source shall be deposited in the state treasury at least once each month, and credited by the department to the proper fund.”); *id.* § 37.10.100(a) (in an action instituted by the AG, “[t]he necessary and reasonable costs of the suit and of the additional counsel shall be advanced by the state, and a sum recovered in the suit shall be deposited in the state treasury”); Colo. Rev. Stat. § 24-31-101(1)(d) (“Any moneys received by him belonging to the state or received in his official capacity shall be paid forthwith to the department of the treasury and, generally, he shall have such legal duties in regard to the activities of the state and its various departments, boards, bureaus, and agencies as are imposed by law.”); Neb. Rev. Stat. § 84-205(8) (AG must “pay all money received, belonging to the people of the state, immediately upon receipt thereof, into the state treasury”); Tenn. Code Ann. § 9-4-301(a) (“It is the duty of every department, institution, office and agency of the state and every officer and employee of state government . . . collecting or receiving state funds, to deposit them immediately into the state treasury or to the account of the state treasurer in a bank designated as a state depository or to the appropriate departmental account if authorized by § 9-4-302.”).
- 129 Miss. Code Ann. § 7-5-33.
- 130 *Pickering v. Langston Law Firm, P.A.*, 88 So. 3d 1269 (Miss. 2012); *Pickering v. Hood*, 95 So. 3d 611 (Miss. 2012).
- 131 *See* N.Y. State Fin. Law § 121(1) (“[E]very state officer . . . receiving money for or on behalf of the state from fees, penalties, forfeitures, costs, fines, refunds, reimbursements . . . shall on the first day of each month pay into the state treasury all such moneys received from the first through the fifteenth day of the preceding month and on the fifteenth day of each month pay into the state treasury all such moneys received from the sixteenth day through the last day of the preceding month accompanied by a detailed, certified statement thereof[.]”).
- 132 *See id.* § 4(1).
- 133 N.Y. Exec. Law § 63(6).
- 134 *Id.* § 63(15) (“In any case where the attorney general has authority to institute a civil action or proceeding in connection with the enforcement of a law of this state, in lieu thereof he may accept an assurance of discontinuance of any act or practice in violation of such law from any

person engaged or who has engaged in such act or practice. Such assurance may include a stipulation for the voluntary payment by the alleged violator of the reasonable costs and disbursements incurred by the attorney general during the course of his investigation.”).

135 *Id.* § 63(6) (emphasis added).

136 Graglia, *supra* note 3, at 19.

137 Lemos & Minzner, *supra* note 114, at 898.

138 *Id.*

139 *Id.*

140 See 1-2 Antitrust Counseling and Litigation Techniques § 2.01 (quoting NAAG Antitrust & Commerce Report 4 (Feb. 1988)).

141 *Id.* (internal quotation marks and citation omitted).



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