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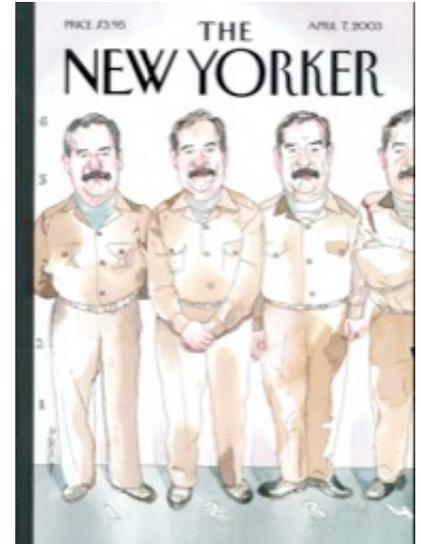
ANNALS OF FINANCE

THE INVESTIGATION

How Eliot Spitzer humbled Wall Street.

by John Cassidy

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Toward the end of 2000, Eric Dinallo, the head of the investor-protection bureau in the New York State Attorney General's office, was talking with his father, Greg Dinallo, a novelist, about the stock market. Investors had already lost billions of dollars, and Greg, who had written episodes of "Quincy, M.E." and "The Six Million Dollar Man" before turning to thrillers, was complaining about Wall Street analysts who kept "buy" recommendations on technology and Internet stocks even though so many of them were plummeting. "When analysts recommend these stocks, what is their interest in it?" he asked. Eric, an athletic thirty-nine-year-old, with short, spiked gray hair, thought this was a good question. The investor-protection bureau existed to protect the interests of ordinary investors. Traditionally, it had targeted individual fraudsters and "boiler rooms" that pumped up penny stocks, but there was no reason it couldn't investigate big Wall Street firms. On January 12, 2001, Dinallo sent a memorandum to his boss, Eliot Spitzer, listing his department's priorities in the coming year. At the top of the list he wrote, "Investigation of abuses by investment advisors." The next entry was "Investigation of investment banking firm analysts."

Dinallo had joined the Attorney General's office at the start of 1999, shortly after Spitzer, a Democrat, defeated the Republican incumbent, Dennis Vacco, in a bitter contest that was resolved only after a recount. Previously, Dinallo had worked in the Manhattan District Attorney's office, where he took part in the successful prosecution of senior executives from A. R. Baron, a crooked brokerage firm. It was, perhaps, surprising for an ambitious young prosecutor to leave the Manhattan D.A.'s office for the Attorney General's investor-protection bureau, but Dinallo knew that Spitzer, the son of a wealthy real-estate developer, had grand ambitions for himself and his office.

Spitzer was thirty-nine when he defeated Vacco, on a Clintonian platform of cleaning up the environment, controlling the spread of guns, and supporting the death penalty. During Spitzer's first two years in office, he had sued power-plant operators in Ohio and elsewhere, for sending air pollution to New York; General Electric, for failing to clean up the Hudson River; and several leading gun manufacturers, for selling unsafe products. Spitzer liked to bait conservative audiences by telling them that his activist agenda was an outgrowth of "federalism," the right-wing legal movement that

advocated the use of state courts, rather than federal courts, to resolve many big issues. At the start of 2001, Spitzer was looking for some bold new initiatives, and he approved Dinallo's idea of taking a closer look at stock analysts.

During the nineteen-nineties, an unprecedented number of Americans had entrusted their money to the stock market, and some had ended up losing heavily. Many Wall Street firms had used the promise of supposedly independent research to draw the public into the market. Some firms even set up mutual funds exclusively devoted to technology and Internet stocks, which they promoted with the aid of their star analysts.



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As a young prosecutor without close political ties to the financial industry, Spitzer was well placed to launch a populist crusade. "Most people on the Street knew that the issue of analysts and

investors was a festering sore," Spitzer said recently. "People had talked about it, but nobody had ever done anything." If there is one thing Spitzer dislikes, it is inaction. Ever since boyhood, he has been competitive and hyperactive. In conversation, he perches his long, angular body on a chair and leans forward, fixing his bright, blue-gray eyes on his interlocutor, as if awaiting the starter's pistol. Although sometimes accused of being a publicity hound, he could hardly be described as a media pretty boy. His chin is prodigious; his teeth are imperfect; his nose is impressive; his brow is furrowed; his hair is receding; and his ears are like jug handles. But he fairly radiates energy and ambition.

Initially, Spitzer had no idea where the analyst inquiry might lead. "It was just one of many investigations," he recalled. "There was no premonition that this was a more important case. It was like everything else. You say, 'Let's see where it takes us.'"

As the top legal official in New York State, Eliot Spitzer heads a sprawling bureaucracy that employs more than eighteen hundred people in offices ranging from Buffalo to Hauppauge. His headquarters takes up eleven floors at 120 Broadway, a grand old office building between Cedar Street and Pine Street which once served as the headquarters of the Equitable Life Assurance Society. The investor-protection bureau, on the twenty-third floor, is one of seven bureaus in the public-advocacy division.

With Spitzer's approval, Dinallo hired Bruce Topman, a sixty-year-old Wall Street attorney, to lead the analyst investigation. During a long career as a litigator, Topman, a slight, dapper fellow who wears French cuffs and suspenders to the office, had defended dozens of firms against the government. Now that his children had left college, he didn't need to earn as much money, and he decided to do something public-spirited. When he arrived at 120 Broadway, he was struck by the disparity of resources between the public and the private sectors. Big Wall Street firms have hundreds of lawyers. The investor-protection bureau employed just ten, and Topman was assigned two of them: Gary Connor, a fifty-five-year-old office veteran, and Patricia Cheng, a thirty-four-year-old expert in information retrieval. Fortunately for Topman, they were determined investigators. "It turned out to be a good combination," Connor said. "Bruce had experience of litigating securities cases. Pat is a computer wizard. And I had experience with the Martin Act."

"The Investigation" continues

