DOES FEDERALISM MATTER? ITS PERPLEXING ROLE IN THE CORPORATE GOVERNANCE DEBATE

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INTRODUCTION

The concept of federalism plays a curious role in shaping our corporate governance policy. Despite the absence of a firm constitutional grounding, federalism arguments have served as a powerful conceptual barrier to sustained federal engagement in corporate governance policy.

When carefully examined, however, notions of federalism add little to the corporate governance debate. A review of academic literature and judicial opinions that seek to enforce notions of federalism shows that efforts to define appropriate boundaries between federal and state authority over corporate regulation are incoherent at best. In the end, such efforts fail because no workable conception exists on which to base such divisions.

The incoherence of federalism doctrines in corporate governance is more than a mere theoretical problem. Efforts to define separate spheres of authority for corporate law and securities regulation often have the practical effect of thwarting the policy objectives of legislators and administrative agencies. Exhortations of federalism also serve as rhetorical ammunition for those opposed to the expansion of federal engagement in corporate governance. In this way, appeals to federalism frequently serve to obfuscate rather than enlighten, distracting policymakers from addressing important substantive concerns.

When evaluating federalism's application to questions of

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corporate regulation, it is important to emphasize that the U.S. Constitution imposes no limits on the reach of federal power. Under the interstate commerce clause it is beyond serious question that Congress can preempt the field of corporate law if it so chooses.[1] Therefore, federalism arguments advanced in the corporate arena are properly understood as normative, rather than constitutional, claims.[2]

The protracted debate regarding the proper division of authority among state and federal regulatory actors is an unfortunate distraction. State and federal regulators alike have vast authority and experience in regulating corporate conduct and securities practices. Therefore, academic discussion should focus on how to best coordinate action among the diverse regulators to maximize the benefits of concurrent authority and minimize its burdens.[3]

The concept of dynamic federalism, which I have described elsewhere, can help to shift conversation in that direction.[4] Dynamic federalism emphasizes the benefits of sustained interaction between state and federal regulators. This model represents modern reality and fairly reflects the framers' vision of our political and constitutional structure.[5]

This Article examines the manner in which federalism concepts have affected the policy debate on corporate governance in the United States.[6] It argues that efforts to carve out separate realms for federal and state regulation have led to the emergence of a number of unstable and imprecise distinctions, including artificial demarcations between corporate and securities law, internal affairs and external affairs, and conduct standards and disclosure rules.[7] It

1. William W. Bratton & Joseph McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 624 (2006) ("The pattern of restraint does not follow from a constitutional mandate . . . .").

2. *See, e.g.*, Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REG., Spring 2003, at 26, 26 ("The question of who gets to regulate public corporations thus is not one of constitutional law but rather of prudence and federalism.").

3. *See infra* Part II.C.

4. *See* Renee M. Jones, *Dynamic Federalism: Competition, Cooperation and Securities Enforcement*, 11 CONN. INS. L.J. 107, 109 (2004).

5. *Id*. at 121-22.

6. The question of federalism's relevance in policy debates arises frequently in a variety of contexts and fields ranging from political science to comparative law and jurisprudence. *See generally*, Susan Rose-Ackerman, *Does Federalism Matter? Political Choice in a Federal Republic*, 89 J. POL. ECON. 152 (1981); Stephen E. Gottlieb, *Does Federalism Matter to its Devotees on the Court*, 23 OHIO N. U. L. REV. 1179 (1997); FEDERALISM AND TERRITORIAL CLEAVAGES (Nancy Bermeo & Ugo M. Amoretti eds., 2004).

7. *See* Robert Ahdieh, *From "Federalization" to "Mixed Governance" in*

also shows how attempts to confine state regulation in securities law to "local" issues and leave "national" issues to Congress and the Securities and Exchange Commission ("SEC") have become hopelessly confused, creating further doctrinal incoherence.[8]

Part I describes the basic federalism arguments that dominate debates on corporate and securities law policies. It notes the instability of many concepts developed to maintain federalism distinctions and the inconsistent manner in which federalism arguments are invoked in the related fields of corporate and securities law. Part II positions the discussion of federalism and corporate governance within a broader context provided by constitutional law commentary. It notes the "sphere of influence" perspective reflected in the Rehnquist Court's New Federalism jurisprudence[9] and catalogues various critiques of the sphere mentality. It also points to efforts by scholars to shift constitutional law discussions away from a focus on divided spheres and toward an emphasis on the interaction between federal and state governments. Part III argues for an integrated approach to corporate regulation. It asserts that corporate and securities law should be treated as an integrated whole, with state and federal regulators all playing an important role in developing policies. This Part argues that an integrated approach offers several advantages from the perspective of democratic policymaking. An integrated approach can also liberate corporate literature from distractions created by unavailing efforts to maintain separate spheres of state and federal authority in corporate governance. An integrated approach can also liberate corporate literature from distractions created by unavailing efforts to maintain separate spheres of state and federal authority in corporate governance.

Corporate Law: A Defense of Sarbanes-Oxley, 53 BUFF. L. REV. 721, 731 (2005) ("No line of sufficient impermeability to categorically exclude any and all possible federal interventions into corporate law can be identified."); Bratton & McCahery, *supra* note 1, at 625 ("The internal affairs norm is fragile, both descriptively and normatively."); Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 8 (1998) (noting the cumbersome distinction between corporate and securities law).

8. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 126 S. Ct. 1503, 1514-15 (2006) (noting that the SEC's Rule 10b-5 gives rise to the possibility of parallel class actions proceedings in state and federal court, with different standards governing claims asserted on identical facts).

9. George D. Brown, *Counterrevolution?—National Criminal Law After* Raich, 66 OHIO ST. L.J. 947, 1011 (2005).

I. FEDERALISM CONCEPTS AND CORPORATE GOVERNANCE

A. Corporate Law: The States' Sphere

A background assumption that grounds much of corporate law scholarship is the notion that a separate sphere of state sovereignty exists in corporate law. This sphere perspective is reflexively asserted, both as a descriptive matter and prescriptively by commentators and the courts.[10] Unfortunately, the insistence on a separate state sphere for corporate regulation rests upon a series of untenable distinctions. Despite their tenuous nature, these fragile distinctions have been reified in corporate commentary and judicial doctrine.

1. Internal Affairs as a Bulwark

Because no constitutional basis exists for limiting federal power in corporate law, corporate federalism claims rely principally on the appeal to a tradition loosely-termed "the internal affairs doctrine." What is often referred to as the internal affairs doctrine actually incorporates two distinct concepts. The first is a choice of law rule which simply provides that when disputes arise between corporate participants (shareholders and directors, for example), the law of the state of incorporation governs the dispute.[11]

The second conception of internal affairs is less definitive. It is best described as an informal understanding among legislators, sometimes enforced by the courts, that matters concerning the internal affairs of a corporation are the province of state law and not a proper subject for federal regulation.[12] As generally understood, internal affairs include those rules governing the relationship among directors, executives, and shareholders.[13]

The problem with this conception of internal affairs is that it is unavoidably circular. What constitute internal affairs are simply those matters that the federal government has permitted states to continue to regulate.[14] This conception also inaccurately implies

10. *See, e.g.*, Alan R. Palmiter, *The CTS Gambit: Stanching the Federalization of Corporate Law*, 69 WASH. U. L.Q. 445, 451 (1991) ("It is a deep-rooted tradition that the ordering of the relationship between managers and shareholders—corporate law—rests primarily with the states.").

11. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

12. Bratton & McCahery, *supra* note 1, at 624; Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 596-97 (2003).

13. LEWIS D. SOLOMON ET AL., CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS 173 (4th ed. 1998).

14. *See, e.g.*, FRANKLIN A. GEVURTZ, CORPORATION LAW 36 (2000) ("[C]orporate internal affairs pretty much encompass the subject matter of those state laws typically referred to as corporate law.").

that federal rules do not address many topics that, according to the general definition, ought to be considered part of internal affairs. A significant amount of federal law addresses matters such as shareholder voting, executive compensation, accounting practices, and insider trading—topics that are part of the "internal affairs" domain.[15] Everyone acknowledges these federal forays into internal affairs, but they are frequently characterized as isolated exceptions to the internal affairs rule.[16]

Despite its inherent instability as a definitional concept, the internal affairs doctrine functions to protect a defined sphere of state power, ensuring that lax state corporate laws flourish with minimal interference from Congress or the SEC.[17] Federalism's most prominent influence on corporate law has been through market-based arguments that emphasize the economic benefits said to flow from federalism. Defenders of corporate federalism point to myriad economic benefits they claim flow from maintaining a decentralized system for devising corporate law to protect the states' regime from federal intervention.[18] Their claims lie at the center of the dominant debate in corporate law as to whether competition among states for corporate charters has spurred a race to the top or a race to the bottom.

In this familiar debate, race to the bottom theorists assert that competition among states for charters has led to the systematic dilution of corporate law rules.[19] They argue that states compete against each other for the fees they charge to corporations chartered in their states.[20] This competition encourages states to adopt rules that favor managers at the expense of shareholders and other constituencies.[21] In contrast, race to the top theorists argue that competitive forces have had a positive effect on corporate law by

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15. *See* Bratton & McCahery, *supra* note 1, at 625.

16. *See, e.g.*, GEVURTZ, *supra* note 14, at 241 ("In several areas . . . federal statutes and rules have made inroads into the normally state domain of corporate law."); CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: CASES AND MATERIALS 141 (4th ed. 2003) ("[F]ederal law may sometimes directly or indirectly preempt state law rules or fill in gaps in the state law structure."). *See also* Roe, *supra* note 12, at 597-98 (noting that many scholars view the federal impact on corporate law as "interstitial, weak, temporary, and exceptional").

17. *See* Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 663 (2004).

18. *See, e.g.*, ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14-15 (1993).

19. *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 665-66 (1974).

20. *Id.* at 664-66.

21. *Id.* at 665-66.

encouraging the adoption of efficient legal rules.[22] These theorists maintain that competition encourages innovation and experimentation which improves the content of corporate law in all states.[23]

This thirty-year debate has reached a stalemate, with neither side yielding much ground to the other. Having approached the debate from antithetical policy perspectives, each side advances arguments consistent with their pre-formed perspective and simultaneously derides opposing arguments. The debate also tends to disregard the effect of the federal constraint on the range of topics with respect to which states can compete.[24] The overlay of federal regulations limits the extent to which states can achieve optimal rules (in the race to the top view) or pander shamelessly to management (in the race to the bottom view).[25]

2. The Disclosure/Conduct Distinction

The commitment of courts and commentators to preserve internal affairs as an exclusive state domain has generated cumbersome efforts to discern a barrier between those issues that belong within the federal securities law domain and those that should be viewed as internal governance matters. This has led to the creation of an artificial boundary that relies on the overgeneralization that securities law is disclosure-based rather than conduct-oriented. Some scholars and judges thus reason that regulating the *conduct* of corporate officers and directors is within the states' sphere, and not a matter governed by the federal securities laws.

By pressing this dichotomy, federalism principles have been invoked to constrain the interpretation of the federal securities laws, preserving a swath of corporate law terrain for the states. The spurious disclosure/conduct distinction has served as the basis for a number of federal court decisions that have invalidated certain SEC rules or rejected a broad interpretation of the securities laws as inconsistent with the "disclosure" objectives of the statutes.

Santa Fe Industries, Inc. v. Green[26] illustrates the courts' frequent insistence on maintaining a bright line between the corporate and securities law domains.[27] In *Santa Fe*, the Supreme

22. *See, e.g.*, Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 275-76 (1977).

23. *See id.* at 276.

24. *See* Bratton & McCahery, *supra* note 1, at 650-53.

25. Roe, *supra* note 12, at 591-92 (arguing that the conventional race debate ignores the federal government's influence on state law).

26. 430 U.S. 462 (1977).

27. *Id.* at 478-79.

Court closed off an avenue for expanding corporate liability under Rule 10b-5 of the Securities Exchange Act of 1934 (the "Exchange Act").[28] The Court declined to extend Rule 10b-5 to capture a breach of fiduciary duty in a short-form merger. In rejecting an expansive reading of the meaning of "fraud" under Rule 10b-5, the Court argued that such a "result would . . . bring within the Rule a wide variety of corporate conduct traditionally left to state regulation,"[29] and that such an extension of securities law "would overlap and quite possibly interfere with state corporate law."[30] Finally, the Court held that "[a]bsent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden."[31]

In *Business Roundtable v. SEC*,[32] the D.C. Circuit also relied on the disclosure/conduct distinction to invalidate the SEC's adoption of Exchange Act Rule 19c-4.[33] Rule 19c-4 required the stock exchanges to maintain a one share/one vote rule for the common stock of all companies listed on the exchanges.[34] The *Business Roundtable* court held that the SEC lacked the authority to issue the rule because Congress did not intend to grant the agency such broad latitude under the Exchange Act.[35]

The SEC had promulgated the rule under Section 19(c) of the Exchange Act, which authorizes the agency to amend stock exchange rules, among other reasons, "as [it] deems necessary or

28. *Id.* at 474. For discussions of the federalism implications of *Santa Fe*, see Bratton & McCahery, *supra* note 1, at 656, 656 n.180; Ralph C. Ferrara & Marc I. Steinberg, *A Reappraisal of* Santa Fe*: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980); Donald C. Langevoort, *Seeking Sunlight in* Santa Fe's *Shadow: The SEC's Pursuit of Managerial Accountability*, 79 WASH. U. L.Q. 449, 451 (2001).

29. *Santa Fe*, 430 U.S. at 478.

30. *Id.* at 479.

31. *Id.* The majority in *Santa Fe* also maintained that the "'fundamental purpose' of the Act [is] implementing a 'philosophy of full disclosure'" and that fairness is "at most a tangential concern of the statute." *Id.* at 478 (citations omitted). Two concurring justices declined to join Part IV of the opinion, which contained these assertions. Justice Stevens maintained that the "entire discussion in Part IV is unnecessary to the decision of this case." *Id.* at 481 (Stevens, J., concurring in part).

32. 905 F.2d 406 (D.C. Cir. 1990).

33. *Id.* at 411-12.

34. For a discussion of the history and the policy considerations underlying the one share/one vote rule see Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687 (1986).

35. *Business Roundtable*, 905 F.2d at 413.

appropriate . . . in furtherance of the purposes of [the Exchange Act]."[36] Taken literally, this language is almost a blank check for the SEC to impose what it views as proper rules on the exchanges. The court, however, found the rule invalid because it "directly controls the substantive allocation of powers among classes of shareholders."[37] Drawing on the Exchange Act's legislative history, the court reasoned that disclosure had been Congress's central concern when adopting the Exchange Act.[38] The SEC's new rule, however, went beyond disclosure, and interfered too directly "with the substance of what the shareholders may enact."[39]

The court did not rely solely on legislative history to ground its decision. It also asserted that the internal affairs doctrine dictated the result. The court worried that if the SEC's authority was broadly validated, the agency "would be able to establish a federal corporate law by using access to national capital markets as its enforcement mechanism,"[40] and thus "overturn or at least impinge severely on the tradition of state regulation of corporate law."[41] The court also invoked a classic slippery-slope argument, asserting that "[i]f the Commission's one share/one vote rule is to survive, then, some kind of firebreak is needed to separate it from corporate governance as a whole."[42]

Despite its centrality to federal corporate jurisprudence, the characterization of the federal securities laws as disclosure oriented is inexact and incomplete. Such characterization sets aside many aspects of the securities laws that directly proscribe conduct. Although it is true that disclosure is the primary method relied upon under federal law to regulate the securities markets, this historical choice has been ascribed unwarranted significance in interpreting

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36. Securities Exchange Act of 1934 (Exchange Act) § 19(c), 15 U.S.C. § 78s(c) (2000).

37. *Business Roundtable*, 905 F.2d at 407.

38. *Id.* at 410-11. A contrary view of the scope of the SEC's rulemaking authority is provided by Joel Seligman:

> Rather than providing the new Commission with a clear mandate, the legislators had granted the agency authority to study the controversy or issue its own rules. In effect, Congress had broadly defined the Commission's areas of expertise and invited it to forge its own mandate . . . . [Congress gave] the SEC vague powers to use its discretion in issuing rules where appropriate 'in the pubic interest and for the protection of investors.'

JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 99-100 (revised ed. 1995).

39. *Business Roundtable,* 905 F.2d at 411.

40. *Id.* at 412.

41. *Id.*

42. *Id.* at 413.

the securities laws.[43]

At least since the adoption of the Exchange Act in 1934, an important objective of federal securities laws has been to regulate the conduct of corporate officials.[44] Several original provisions of the Exchange Act, such as Section 14's proxy solicitation requirements and Section 16's short-swing trading prohibitions, are conduct standards.[45] Over the years, Congress has added many significant conduct provisions to the statute.

The Sarbanes-Oxley Act of 2002 may be the most widely-discussed instance of explicit federal conduct regulation, yet long before the recent scandals Congress was engaged in setting corporate governance policy.[46] The Williams Act and the Foreign Corrupt Practices Act are examples of prior federal conduct regulation. The Williams Act, adopted in 1968, regulates tender offers, restricting the actions of investors seeking to acquire corporations through hostile tender offers, as well as the responses of the target corporations.[47] The Foreign Corrupt Practices Act[48] was adopted in 1977 in response to reports of the widespread use of corporate slush funds for bribery, illegal campaign contributions, and other illegitimate purposes.[49] It prohibits foreign bribery[50] and requires publicly traded corporations to maintain standards for internal controls over corporate books and records.[51] The internal control requirements aimed not only to improve the accuracy of financial reporting, but also sought to provide investors greater

43. *See* Palmiter, *supra* note 10, at 477 ("Nothing compelled the Court's operating assumption that the federal securities laws were meant only to regulate corporate disclosure.").

44. JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 557-58 (5th ed. 2006) (noting that an important theme of the Exchange Act is to regulate aspects of the behavior of issuers and their managers whose stock was traded on the exchanges).

45. Exchange Act §§ 14(a), 16(a)-(b), 15 U.S.C. §§ 78n(a), 78p(a)-(b) (2000). *See also* SELIGMAN, *supra* note 38, at 87 (describing the Exchange Act's proxy requirements and insider trading provisions as the Roosevelt administration's first efforts to directly regulate corporate governance).

46. *See* Roe, *supra* note 12, at 598. Sarbanes-Oxley includes numerous mandatory provisions covering board and audit committee composition and duties, bans on loans to executives, financial certification requirements, and whistle-blower protections, all of which go to the heart of corporate internal affairs. *Id*. at 633.

47. Exchange Act §§ 13(d)-(e), 14(d)-(f), 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2000 and Supp. III 2003).

48. Pub. L. No. 95-213, 91 Stat. 1494 (1977).

49. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 421 (4th ed. 2002).

50. Exchange Act § 30A, 15 U.S.C. § 78dd-2 (2000).

51. Exchange Act § 13(b)(2), 15 U.S.C. § 78m(b)(2) (Supp. III 2003).

assurances regarding the integrity of management.[52]

Supplementing these statutory requirements are SEC disclosure rules aimed at altering the conduct of corporate officers and directors.[53] These rules require detailed disclosures regarding audit committee composition, executive compensation, conflicts of interest, and illegal conduct.[54] Congress also regulates corporate governance through federal tax provisions aimed at influencing practices related to executive compensation, employee pensions, and the payment of corporate dividends.[55] When the New York Stock Exchange's comprehensive corporate governance standards are added to the analysis, the disclosure/conduct distinction becomes even more untenable.[56]

In sum, the extent of direct conduct regulation under the federal securities laws is so significant that the disclosure/conduct distinction has little merit as a basis for limiting the expansion of federal power in this realm.[57] Despite significant departures from the disclosure model that began in 1934, the history of federal securities regulation has been redescribed by judges and commentators in order to constrain the interpretation and application of these statutes within the disclosure framework as much as possible.

52. COX ET AL., *supra* note 44, at 57.

53. *See* Bratton & McCahery, *supra* note 1, at 624 n.8 ("The disclosure mandates significantly impact day-to-day conduct of business, despite their formal denomination as market regulation."); O'KELLEY & THOMPSON, *supra* note 16, at 199 ("Sometimes disclosure is a thinly disguised effort to change the substance of the behavior by an officer or director . . . something that traditionally would be determined by state law.").

54. *See* SEC Regulation S-K, 17 C.F.R. § 229.400 (2005).

55. *See* Steven A. Bank, *Tax, Corporate Governance, and Norms*, 61 WASH. & LEE L. REV. 1159, 1160-61 (2004); Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53, 134 (1990) (describing the 1909 Corporate Excise Tax as an effort at corporate regulation); James R. Repetti, *Corporate Governance and Stockholder Abdication: Missing Factors in Tax Policy Analysis*, 67 NOTRE DAME L. REV. 971, 1017, 1026-27 (1992).

56. Robert B. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 WAKE FOREST L. REV. 961, 963 (2003); NYSE LISTED COMPANY MANUAL § 303A (2003) (NYSE Corporate Governance Rules), *available at* http://www.nyse.com/pdfs/finalcorpgovrules.pdf.

57. *See* Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 201-03 (2006).

B. Securities Law: The Federal Sphere

Within the federal government's acknowledged sphere—securities law—federalism issues also permeate the policy debate. Here the question centers on the division of authority among state and federal officials. Along this dimension, developments run counter to what notions of federalism would seem to support. The tradition of respect for state authority in securities regulation has significantly eroded, as Congress has acted to limit the states' authority to enforce their own laws. Unlike corporate law, where the virtues of federalism are front and center, when it comes to determining the proper allocation of authority between federal and state authorities in securities law, federalism's supposed advantages tend to be disregarded or dismissed.[58]

Although most power over the securities markets is exercised by federal authorities, Congress reserved for the states concurrent power to regulate securities transactions.[59] Thus, an important issue in securities law concerns the division of authority between state officials and federal authorities. The conventionally accepted division of authority relegates to the states the exercise of local administrative and enforcement duties, leaving to Congress and the SEC the task of establishing a national policy for the securities markets.[60] Actions by state officials that challenge this informal division of power invariably trigger calls for federal preemption from corporate quarters.

When it adopted the federal securities laws, Congress opted for a uniform system of national regulation to supplement existing state laws.[61] This dual-regulatory structure recognized that the states' continued involvement in securities regulation was necessary to provide remedies beyond those which the new federal statutes created.[62] Over time, this structure has been forcefully criticized.

58. Portions of this discussion are adapted from Jones, *supra* note 4, at 110-16.

59. The Securities Act of 1933 [hereinafter Securities Act] and the Exchange Act both contained savings clauses, preserving the continued viability of state securities statutes. *See* Securities Act § 18(c), 15 U.S.C. § 77r(c) (2000); Exchange Act § 28(a), 15 U.S.C. § 78bb(a) (2000).

60. Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2365 (1998) ("[S]tates have essentially abandoned the regulation of public firms to the SEC.").

61. *See supra* note 59 and accompanying text.

62. Manning Gilbert Warren III, *Reflections on Dual Regulation of Securities: A Case Against Preemption*, 25 B.C. L. REV. 495, 515-25 (1984). *See also* Manning Gilbert Warren III, *Reflections on Dual Regulation of Securities: A Case for Reallocation of Regulatory Responsibilities*, 78 WASH. U. L.Q. 497,

Corporations complained that the system was duplicative and wasteful because it required companies to contend with the costs and inconvenience of complying with federal securities laws as well the laws of every state in which their securities traded.[63] Beginning in the 1990s, this dual regulatory structure was subject to a full-scale legislative assault.[64]

1. The National Securities Markets Improvement Act of 1996

Criticism of state blue sky laws led first to efforts to coordinate federal and state exemptions from the securities laws' registration requirements.[65] The objective was to ensure that if a securities offering satisfied the exemption requirements of one state, it would also qualify for similar exemptions available from other states and the SEC.[66] When these coordination efforts failed, the securities industry pushed for the adoption of the National Securities Markets Improvement Act of 1996 ("NSMIA").[67] NSMIA prohibits states from enforcing their registration requirements for offerings of "listed securities" and most private placements.[68]

2. The Securities Litigation Uniform Standards Act

In 1998, Congress acted again to limit the states' authority in securities regulation. This time preemption advocates argued that securities suits filed in California were undermining the strict procedural rules mandated by the Private Securities Litigation Reform Act ("PSLRA").[69] They therefore lobbied for federal

504 (2000).

63. *See* H.R. Rep. No. 104-864, at 39 (1996) (Conf. Rep.), *as reprinted in* 1996 U.S.C.C.A.N. 3920.

64. *See, e.g.*, Rutheford B. Campbell, Jr., *The Insidious Remnants of State Rules Respecting Capital Formation*, 78 WASH. U. L.Q. 407, 411-13 (2000).

65. *See* Small Business Investment Incentive Act of 1980 § 505, Pub. L. No. 96-477, 94 Stat. 2275, 2292-93 (1980) (adding Section 19(c) to the Securities Act); Roberta S. Karmel, *Reconciling Federal and State Interests in Securities Regulation in the United States and Europe*, 28 BROOK. J. INT'L L. 495, 507-08 (2003).

66. *See* Campbell, *supra* note 64, at 412.

67. Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified in scattered sections of 15 U.S.C.).

68. Securities Act § 18(a), 15 U.S.C. § 77r(a) (2000). NSMIA prohibits states from enforcing registration or qualification requirements for any "covered security." NSMIA's definition of "covered security" includes any securities listed, or to be listed, on a national stock exchange or the Nasdaq National Market and all securities sold under Securities Act Rule 506, the SEC's private placement safe harbor. *Id.* § 77r(b)(1), (4).

69. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.). Among other reforms, the PSLRA created new lead plaintiff provisions for securities class actions, imposed heightened pleading standards

preemption of securities fraud actions brought in state court.[70] In response to these complaints, Congress adopted the Securities Litigation Uniform Standards Act ("SLUSA"), which preempts most securities class actions based on state law, authorizing their removal to federal court.[71]

The prospect of federal preemption of state securities laws appealed to its proponents only because of a complementary trend that had developed in the federal courts and in Congress. This so-called "retrenchment" trend began in the 1970s and has been marked by a series of Supreme Court decisions that narrowed the remedies available to investors under the federal securities laws.[72] In 1995, Congress adopted the PSLRA, which codified many of the Court's defendant-friendly doctrines and created additional barriers to plaintiffs pursuing securities fraud claims.[73]

3. The States' Ascendancy

The preemption efforts discussed above focused on limiting state authority over securities registration and the private civil

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for securities fraud claims, codified the "bespeaks caution" doctrine to immunize companies from liability for false projections, and imposed a mandatory stay on discovery pending a defendant's motion to dismiss. *See* DONNA M. NAGY ET AL., SECURITIES LITIGATION AND ENFORCEMENT: CASES AND MATERIALS 395-402 (2003). Some commentators have challenged the empirical basis for the Securities Litigation Uniform Standards Act (the "SLUSA") proponents' claims that state law suits were undermining the PSLRA. *See* Manning Gilbert Warren III, *Federalism and Investor Protection: Constitutional Restraints on Preemption of State Remedies for Securities Fraud*, 60 LAW & CONTEMP. PROBS. 169, 178 (1997).

70. The high-tech industry in Silicon Valley and the American Institute of Certified Public Accountants were the leading proponents of the both the PSLRA and SLUSA. *See* David M. Levine & Adam C. Pritchard, *The Securities Litigation Uniform Standards Act of 1998: The Sun Sets on California's Blue Sky Laws*, 54 BUS. LAW. 1, 2 (1998); Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 288 n.70 (1998); Painter, *supra* note 7, at 4-6.

71. Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified as Securities Act §16(b), 15 U.S.C. § 77p(c) (2000) and Exchange Act § 28(f), 15 U.S.C. § 78bb (2000)). SLUSA prohibits the litigation of any "covered class action based upon the statutory or common law of any State" for fraud in connection with the purchase or sale of a covered security. The act defines a "covered class action" as a law suit seeking damages on behalf of fifty or more plaintiffs. A "covered security" is defined as a security that is listed or authorized for listing on a national stock exchange and any other security of the same issuer of equal or higher seniority. Securities Act § 16(b), 15 U.S.C. § 77p(b), 77p(f)(2) (2000); Exchange Act § 28(f), 15 U.S.C. § 78bb(f)(5)(C) (2000). *See* Levine & Pritchard, *supra* note 70, at 2-3.

72. *See* Levine & Pritchard, *supra* note 70, at 5 & n.23.

73. *See* Warren, *supra* note 69, at 170-74.

litigation of securities fraud claims. The statutes preserved states' power to enforce their securities laws through civil and criminal actions initiated by state officials.[74] At the time, preserving the states' enforcement powers was uncontroversial because state and federal regulators had informally divided enforcement duties in a manner that appealed to business interests. State regulators focused their enforcement efforts on pursuing small-time fraud actions against individuals and local firms (boiler rooms, Ponzi schemes, and the like) and left the SEC to pursue cases of national importance involving large, established companies.[75]

Early in this century, this informal equilibrium faltered when New York Attorney General Eliot Spitzer began to investigate questionable industry practices that had taken root on Wall Street.[76] These efforts began with Mr. Spitzer's high-profile probe of analyst conflicts on Wall Street. In 2001, Mr. Spitzer's office opened an investigation into Merrill Lynch's analyst recommendations. This investigation revealed that Merrill Lynch's analysts did not always believe the advice they gave investors, confirming suspicions that such recommendations were tainted by concerns with maintaining lucrative investment banking relationships.[77] Merrill Lynch settled the matter by paying $100 million in fines and agreeing to separate its research and investment banking functions.[78] After the Merrill Lynch settlement, Mr. Spitzer joined forces with the SEC, the New York Stock Exchange, the National Association of Securities Dealers, and other state regulators. Working together, the agencies conducted a comprehensive investigation of analyst fraud at other Wall Street firms. The expanded investigation revealed similar conflicts at other firms and led to the $1.4 billion "global settlement" among ten Wall Street firms, the SEC, the self-regulatory organizations ("SRO"), and all fifty states.[79]

74. Securities Act § 18(c)(1), 15 U.S.C. § 77r(c) (2000). *See also* Warren, *supra* note 69, at 176.

75. *See* Perino, *supra* note 70, at 279 (describing state regulators as "local cop[s] on the beat" with a traditional "consumer protection" role).

76. *See* John Cassidy, *The Investigation; How Eliot Spitzer Humbled Wall Street*, NEW YORKER, Apr. 7, 2003, at 54. *See also* ARTHUR LEVITT, TAKE ON THE STREET 74-81 (2002) (describing the SEC's inability to effectively address analyst conflicts).

77. Charles Gasparino, *Merrill Lynch will Negotiate with Spitzer*, WALL ST. J., Apr. 15, 2002, at C1.

78. *See* Cassidy, *supra* note 76, at 53.

79. *See* Gretchen Morgenson & Patrick McGeehan, *Wall Street Firms are Ready to Pay $1 Billion in Fines*, N.Y. TIMES, Dec. 20, 2002, at A1. Mr. Spitzer and regulators from other states also led investigations of market-timing and late trading at mutual funds. As one example, Massachusetts Secretary of State William Galvin led the investigation into market-timing practices at

The states' aggressive enforcement posture provoked an outcry from the industries targeted by their investigations. Business groups initiated efforts to expand federal preemption to preclude states from enforcing laws that conflicted with SEC or SRO standards.[80] A number of federal officials, including the SEC's chairman and its enforcement chief, supported these preemption efforts.[81] In Congress, Representatives Michael Oxley and Richard Baker led a failed legislative bid to strip state securities regulators of their enforcement powers.[82] Although these efforts to restrict the states' enforcement powers did not succeed, they show how readily

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Putnam Investments, uncovering serious market-timing violations by senior Putnam employees. *See* Andrew Caffrey, *State, SEC Hit Putnam, 2 Managers Personal Profit Tied to Excessive Rapid Trading*, BOSTON GLOBE, Oct. 29, 2003, at A1; Jeffrey Krasner & Andrew Caffrey, *SEC Missed a Chance in its Probe of Putnam*, BOSTON GLOBE, Nov. 16, 2003, at A1; Beth Healy, *Putnam Agrees to $110M Settlement; Trading Penalty is 10 Times More than Investor Restitution*, BOSTON GLOBE, Apr. 9, 2004, at D1.

80. *See, e.g.*, Press Release, Securities Industry Association, SIA Welcomes NY AG's Support for National Standards for Capital Markets (June 26, 2002) (on file with author). *See also* Kathleen Day, *Brokerage Settlement Leaves Much Unresolved: SEC Acknowledges Need for New, Specific Rules*, WASH. POST, Apr. 30, 2003, at E1; Gretchen Morgenson, *State Regulators Win Some, Lose Some*, N.Y. TIMES, Feb. 29, 2004, § 3, at 8.

81. *See* Stephen M. Cutler, Director, Division of Enforcement, U.S. Securities and Exchange Commission, Remarks at the F. Hodge O'Neal Corporate and Securities Law Symposium, 81 WASH. U. L.Q. 545, 552-53 (2003) ("Congress clearly intended, when it adopted NSMIA, that the *federal* government, not the states, establish the rules and policies governing the securities markets, and that it do so on a national, rather than piecemeal, basis."); *Hearing on Nomination of William H. Donaldson Before the Sen. Comm. on Banking, Housing, and Urban Affairs*, 108th Cong. 25 (2003) (Statement of William H. Donaldson) ("I think that one of the great strengths of our market system is that it is a national market system and has not been [B]alkanized."); Judith Burns, *SEC Warns of Uncoordinated Inquiries*, WALL ST. J., Sept. 10, 2003, at C14 (quoting Chairman Donaldson as stating, "state law enforcement officials are jumping on securities cases for political gain and may compromise federal investigations in the process").

82. Letter from Representative Michael G. Oxley to the Editor, N.Y. TIMES, June 9, 2002, § 3, at 11 ("[S]etting policy for our national capital markets is properly the duty and responsibility of the Securities and Exchange Commission and the self-regulatory organizations."). Congressman Baker introduced a provision that would have prevented states from enforcing any state requirements against brokers and dealers that differed from rules established by the SEC or the stock exchanges. STAFF OF H.R. SUBCOMM. ON CAPITAL MKTS., INS., & GOV'T SPONSORED ENTERS., 108TH CONG., FAIR ACT AMENDMENTS 24-25 (Comm. Print 2003). He withdrew his proposed amendment after sustained negative commentary from defenders of the states' enforcement efforts. *"Anti-Spitzer" Provision to be Removed from Bill*, CHI. TRIB., Feb. 25, 2004, § 3, at 3.

federalism's positive values can be discounted when they conflict with other political interests.

To summarize, unlike corporate law where federalism arguments support state sovereignty, the recent trend in securities law has been to limit state power. With legislation such as NSMIA and SLUSA, Congress overturned a seventy-year tradition of federal deference to state authority in the securities arena. Federalism's values of competition, responsiveness, and innovation were rarely mentioned in policy debates and, when pondered, were often deemed outweighed by the need for uniformity.[83]

II. CORPORATE FEDERALISM IN PERSPECTIVE

A. Federalism's Dissonant Application Across Corporate Governance Fields

Considerable dissonance exists between the central role that federalism has played in the corporate law debate and the ease with which its vaunted attributes are rejected in securities law discussions.[84] The very attributes of decentralization that defenders of corporate federalism celebrate (diversity, experimentation, and competition) are decried by those who advocate for a single central authority to regulate the national securities markets.[85] Although some scholars have proposed duplicating the corporate federalist structure in securities regulation by allowing issuers to "opt out" of federal securities regulation, a chorus of academic commentary has supported calls for uniformity via the expansion of federal regulatory hegemony in securities regulation.[86]

83. *See, e.g.*, Perino, *supra* note 70, at 278 ("[N]one of the traditional justifications for allocating authority to the states applies to the regulation of private causes of action against issuers whose securities trade on national markets."). *But see* Stephen J. Choi, *Promoting Issuer Choice in Securities Regulation*, 41 VA. J. INT'L L. 815, 856-57 (2001) (arguing that securities law would benefit from choice and innovation brought about by regulatory competition, rather than uniform federal law); Romano, *supra* note 60, at 2392-95, 2631 (advocating a market-oriented approach of competitive federalism that would expand the role of states in securities regulation).

84. Ahdieh, *supra* note 5, at 735 ("Taken to their logical[,] and relatively proximate, conclusion, federalism arguments . . . favor the shift of both corporate and securities regulation to the states.").

85. *See* Painter, *supra* note 7, at 13-14.

86. *Compare* Choi, *supra* note 83, at 857 *and* Romano, *supra* note 60, at 2401 (supporting issuer choice in securities regulation) *with* Campbell, *supra* note 64, at 411-13 *and* Perino, *supra* note 70, at 338 (supporting preemption of state securities laws). *See also* Karmel, *supra* note 65, at 546 (arguing that "[s]ince the problems are national, and in some respects international in scope, an effective national regulator seems more appropriate than piecemeal state

The apparent discrepancy between the prominence of federalism arguments in corporate law and their curious omission from discussions in securities law policy is puzzling. Why should a set of values so central to corporate law discussions be set aside in the literature of the inexorably connected field of securities law?

One possible explanation is the limiting effect of cognitive habits of categorization. Academics tend to specialize in their research and writing, choosing to focus their intellectual energy in one field or another. Due to such specialization, important insights in one field do not automatically migrate to other fields where they might be useful and relevant. While this is true, it is important to note that many professors of corporate law also teach securities regulation, and many of these professors write frequently in both fields. Habits of categorization can certainly constrain one's thinking, closing off certain thought patterns when discussing different areas of law. However, the substantial overlap and interplay between corporate and securities law suggests that categorization provides only a partial explanation of the discrepancy noted.

Another way to reconcile this discrepancy is to view appeals to federalism as a rhetorical tactic in a more generalized effort to limit regulation of any kind. It is well recognized that many advocates of federalism are generally opposed to the expansion of federal administrative power.[87] More generally, and less widely acknowledged, federalism proponents favor minimizing the intrusion of government *at any level* in the private ordering of economic affairs.[88]

This added nuance helps explain the apparent inconsistency in the strong support that exists for decentralization of corporate law rules with the quiet acceptance of federal preemption of state securities provisions. The salient difference lies not in the theoretical possibilities of reaping benefits from experimenting with varied substantive standards in these legal regimes, but rather in

regulation."); Steve A. Radom, Note, *Balkanization of Securities Regulation: The Case for Federal Preemption*, 39 TEX. J. BUS. L. 295, 306-19 (2003) (arguing that preemption may be necessary to prevent a "Balkanized" system of securities regulation).

87. *See* H. Geoffrey Moulton, Jr., *The Quixotic Search for a Judicially Enforceable Federalism*, 83 MINN. L. REV. 849, 892 (1999); Judith Resnik, *Categorical Federalism: Jurisdiction, Gender, and the Globe*, 111 YALE L.J. 619, 641 (2001); Edward L. Rubin & Malcolm Feeley, *Federalism: Some Notes on a National Neurosis,* 41 UCLA L. REV. 903, 931 (1994).

88. Ahdieh, *supra* note 7, at 740 ("[I]t is not federal law to which critics of the [Sarbanes-Oxley] Act's 'federalization' object; it is law—or at least law in a command-and-control, regulatory sense.").

the identity of the party empowered to choose among competing regimes. In corporate law, managers choose the state of incorporation and thus have the power to select those laws which will govern their behavior.[89] In securities regulation, the party seeking to enforce the law (whether a private plaintiff or a government official) chooses whether to assert a claim under a given regulatory regime.[90]

There are several reasons that opponents of regulation might choose to couch their arguments in federalism terms.[91] As Professors Edward Rubin and Malcolm Feeley colorfully explain, "[federalism] conjures up images of Fourth of July parades down Main Street, drugstore soda fountains, and family farms with tire swings in the front yard."[92] By appealing to history, tradition, and the founders' intent, advocates can help forestall a normative critique of the status quo. Another advantage to opposing regulation through appeals to federalism is that such arguments appear neutral as to the substance of the regulation.[93] This seemingly detached position allows its proponents to obscure the true nature of their objection while still thwarting the implementation of policies which they oppose.[94] After all, the interlocutor is challenging the authority of the actor rather than the wisdom or desirability of the proposed regulatory action.

As professors Rubin and Feeley observe, "[t]his is perfectly good

89. Robert A. Prentice, *Regulatory Competition in Securities Law: A Dream (That Should be) Deferred*, 66 OHIO ST. L.J. 1155, 1158 (2005).

90. *See, e.g.*, Securities Act §§ 11-12, 15 U.S.C. §§ 77k, 77*l* (2000).

91. DAVID L. SHAPIRO, FEDERALISM: A DIALOGUE 37 (1995).

92. Rubin & Feeley, *supra* note 87, at 906. Note, however, that even prominent proponents of federalism seem quick to abandon it when its implications are inconvenient to their policy objectives. For recent examples, consider Republican support for a constitutional ban on gay marriage and the Terry Schiavo bill. *See also* Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism,* 76 VA. L. REV. 265, 265 (1990). Macey states:

> Conservatives and liberals alike extol the virtues of state autonomy whenever deference to the states happens to serve their political needs at a particular moment. Yet both groups are also quick to wield the power of the supremacy clause, while citing vague platitudes about the need for uniformity among the states, whenever a single national rule in a particular area furthers their political interests.

Id.

93. *See, e.g.*, Business Roundtable v. SEC, 905 F.2d 406, 407 (D.C. Cir. 1990) ("Neither the wisdom of the requirement, nor of its being imposed at the federal level, is here in question.").

94. Put another way, the "[p]reference for a vague critique of 'federalization' over a broad condemnation of regulation is hardly surprising . . . given the likely greater resonance of an implied defense of doctrinal consistency and coherence." Ahdieh, *supra* note 7, at 740.

political strategy, but it is hardly a convincing argument for federalism."[95] Deregulatory arguments disguised as federalism provide little aid in situating regulatory authority with the proper level of government. After all, the goal of many such federalists is not properly situated regulation, but no regulation at all. Once we recognize that many appeals to federalism are merely rhetorical tactics within a broader political strategy for promoting deregulation, we can more appropriately evaluate the arguments federalists advance in the corporate sphere.

B. New Federalism: The "Sphere" Perspective

Federalism arguments in corporate law suffer from the same shortcomings as parallel arguments advanced in the constitutional context. Thus, a brief review of how the sphere of influence perspective has influenced constitutional law theory should lead to a better understanding of federalism's role in corporate law debates.

The sphere of influence mentality that dominates corporate law theory is reflected in broader constitutional scholarship.[96] The view is best exemplified by the Supreme Court's New Federalism jurisprudence, under which the Court has invalidated a number of federal statutes on the grounds that they run afoul of constitutional limits on Congressional power.[97] Decisions such as *United States v. Lopez*[98] and *United States v. Morrison*[99] reignited a debate among constitutional law scholars over the proper role of the courts in defining the boundaries of Congressional authority.[100]

95. Rubin & Feeley, *supra* note 87, at 935.

96. *See* Steven G. Calabresi, *"A Government of Limited and Enumerated Powers": In Defense of* United States v. Lopez, 94 MICH. L. REV. 752, 830 (1995); Marci A. Hamilton, *Why Federalism Must be Enforced: A Response to Professor Kramer*, 46 VILL. L. REV. 1069, 1085 (2001); Ernest A. Young, *The Rehnquist Court's Two Federalisms*, 83 TEX. L. REV. 1, 163 (2004).

97. *See* United States v. Morrison, 529 U.S. 598, 617 (2000) (striking down aspects of the Violence Against Women Act of 1994); United States v. Lopez, 514 U.S. 549, 567 (1995) (ruling the Gun-Free School Zones Act of 1990 unconstitutional); N.Y. v. United States, 505 U.S. 144, 180 (1992). For an overview of New Federalism jurisprudence, see Brown, *supra* note 9, at 1011-12.

98. 514 U.S. 549 (1995).

99. 529 U.S. 598 (2000).

100. In *Lopez*, the Court invalidated the Gun-Free School Zone Act, 18 U.S.C. § 922(q)(1)(A) (Supp. V 1988), on the grounds that it was too tangentially related to commerce to come within Congress's commerce powers. *Lopez*, 514 U.S. at 567. The Act made it a federal offense "for any individual knowingly to possess a firearm at a place that the individual knows, or has reasonable cause to believe, is a school zone." 18 U.S.C. § 922(q)(2)(A). In *Morrison*, the Court ruled that the civil remedy provisions of the Violence Against Women Act, 42 U.S.C. § 13981 (2000), were unconstitutional and thus unenforceable.

Although it has its strong proponents, New Federalism has been forcefully criticized over the years. Detractors argue that many of the benefits claimed for federalism are illusory.[101] For example, Professors Rubin and Feeley argue that many purported features of federalism, such as increased citizen participation and improved responsiveness of government, derive from the historical preservation of autonomy for local governments—counties, cities, and towns—rather than states.[102] The historic autonomy of localities is wholly unrelated to, and may even be threatened by, state autonomy that federalists champion.[103] The authors thus conclude that federalism, as conceived and advanced by its proponents, is "a neurosis, a dysfunctional belief to which we cling despite its irrelevance to present circumstances."[104]

Professor David Shapiro has also questioned many of federalism's central claims. He points out that most economic federalism arguments hinge on a contestable value judgment that free markets are preferable to government regulation.[105] Such arguments also fail to account adequately for barriers to mobility, externalities, and transaction costs, which interfere with the realization of federalism's efficiency claims.[106] Professor Shapiro also challenges the common claim that federalism helps to protect individuals against tyranny. As Professor Shapiro notes, the national government frequently has led the way in protecting individual liberties, often against tyranny and oppression threatened by states.[107]

Morrison, 529 U.S. at 617-18. The court reasoned that "[g]ender-motivated crimes of violence are not, in any sense of the phrase, economic activity," and thus not subject to federal regulation under the commerce clause. *Id*. at 613.

101. *See generally* SHAPIRO, supra note 88; Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485 (1994); Rubin & Feeley, *supra* note 87.

102. Rubin & Feeley, *supra* note 87, at 919-20.

103. *Id*.

104. *Id.* at 950; *see also* Edward L. Rubin, *Puppy Federalism and the Blessings of America,* 574 ANNALS AM. ACAD. POL. & SOC. SCI. 37, 49 (2001).

105. SHAPIRO, *supra* note 91, at 37.

106. *Id*. at 37-44.

107. *Id.* at 52-56 (noting the cases of slavery, Jim Crow, and criminal procedure). Despite his skepticism toward some federalism claims, Professor Shapiro notes the importance of the historical role states play in our political structure and urges maintaining this traditional respect for state authority. *Id*. at 122-23. Although he rejects federalism as a constraint on national authority he does not believe that Congress should replace state law with federal law to the full extent of its enumerated powers. Rather, he argues that state power should be displaced only upon strong arguments by advocates for national action. *Id*. at 118-20. In a conclusion that points toward a dynamic conception of federalism, he states that "the true genius of American federalism lies in the continuing, and constitutionally assured, basis for dialogue—for moral,

Other scholars concede the value of state autonomy, yet object to the Court's efforts to enforce federalism's boundaries. Professor Larry Kramer insists that our political structure protects the states' authority in those areas of law that matter most to citizens in their everyday life.[108] He concludes that because a combination of structural, administrative, cultural, and political forces protect state authority, the Court should not seek to enforce federalism.[109]

C. *The Interactive Perspective*

Weaknesses in the sphere of influence perspective have led scholars to develop alternative conceptions of the federal-state relationship. These alternative theories provide a contrasting perspective on managing the overlap of federal and state power. In advancing the concept of dynamic federalism, I have argued that competition, cooperation, and coordination among state and federal regulators are by-products of a system of concurrent authority that accrues to the public benefit.[110] Just as separation of powers among the executive, legislative, and judicial branches protects against perilous concentrations of power, interaction between federal and state regulators provides built-in checks against abuse of power and expands opportunities for public participation in government.

This emerging view avoids the "New Federalism" debate over how to allocate authority over various issues, and whether such determinations should be made by courts or through the political process. Instead, it views concurrent and overlapping state and federal authority as the norm, not a peculiarity to be resolved. Its proponents argue that rather than resisting this reality, scholars should focus on better understanding the relationship between state and federal power, and facilitating cooperation and coordination among different levels of government.[111]

A recent article by Professor Robert Schapiro provides a comprehensive account of this interactive approach to federalism problems.[112] In his article, Professor Schapiro asserts that "[t]he key

political, economic, and social debate over the merits of the allocation of power . . . among the various branches of government." *Id*. at 140.

108. Kramer, *supra* note 101, at 1521-24. According to Kramer, the national political parties' influence on local, state, and national elections helps ensure that national leaders cooperate with and respect the autonomy of state and local politicians. *Id*. at 1542.

109. *Id*. at 1560-61

110. *See* Jones, *supra* note 17, at 636-39; Jones, *supra* note 4, at 109-10.

111. In Part III of this Article, I present an integrated model of corporate regulation to help facilitate such discussions. See *infra* text accompanying notes 126-69.

112. Robert A. Schapiro, *Toward a Theory of Interactive Federalism*, 91 IOWA L. REV. 243, 285 (2005).

to understanding the promise of federalism lies in considering state and national power not in isolation but in interconnection."[113] He argues that the interaction of state and federal power should be neither prevented nor discouraged. Courts and legislators should instead embrace such interaction as a mechanism that often facilitates the emergence of effective policy solutions.[114]

Interactive federalism gives the public the advantage of examining and benefiting from multiple approaches to solving a particular problem.[115] Maintaining concurrent authority also provides an opportunity for dialogue, allowing each level of government to learn from the other.[116] Furthermore, state and federal governments can provide alternative forms of relief. This regulatory redundancy serves as a "fail-safe mechanism," an additional source of protection if one or the other level of government fails to provide adequate safeguards to the public.[117]

Professor Schapiro's work synthesizes the ideas of other scholars who have argued for a similar approach. These scholars draw insights from the history of interaction between federal and state regulators in various fields and urge a greater appreciation of the beneficial aspects of sustained inter-governmental interaction. For example, Professor Judith Resnik challenges the merits of the federalism arguments behind the Supreme Court's decision in *United States v. Morrison,*[118] invalidating the civil remedy provision of the federal Violence Against Women Act.[119] In that decision, the Court held that matters related to family law and crime were properly within the states' sphere and thus outside the reach of Congress's commerce powers.[120] In criticizing the Court's analysis, Professor Resnik calls for an approach she terms "multi-faceted federalism," advancing the idea that "many categories are intertwined in law-making enterprises and that more than one source of legal regulation is likely to apply to any set of behaviors."[121] She argues that the categorical approach exemplified by New Federalism misses the "dynamic interaction across levels of

113. *Id*. at 248.
114. *Id*. at 285-86.
115. *Id*. at 288.
116. *Id*. at 288-89; *see also* SHAPIRO, *supra* note 91, at 140.
117. Schapiro*, supra* note 112, at 289-90. *See also* Jones, *supra* note 17, at 639 (noting that the state regulatory regime serves as a "safety valve").
118. 529 U.S. 598, 627 (2000).
119. Resnik, *supra* note 87, at 629-34.
120. *Id*. at 619.
121. *Id*. at 622. Under Professor Resnik's concept, "[o]ne level of government may preside over a given set of problems for a given period rather than forever." *Id*. at 623.

governance."[122] She views federalism instead as "a web of connections formed by transborder responses . . . and through shared efforts by national organizations of state officials, localities and private interests."[123] She points out, for example, the many aspects of federal and state law that affect the structure of family life and the personal safety and security of women.[124]

Similarly, Professors Robert Cover and Alexander Aleinikoff have described a process they call "dialectical federalism" to explain how federal and state courts communicate and interact through habeas corpus proceedings and criminal jurisprudence to develop policies and procedures for protecting individual rights in the criminal justice system.[125] Examples of important federal-state interaction also abound in criminal, environmental, and health and safety law.[126] The extension of federal involvement in areas traditionally understood as the states' domain is likely to continue, making it even more important that we understand better how to harness the benefits and minimize the burdens of maintaining concurrent authority in so many areas of law.

III. AN INTEGRATED PERSPECTIVE ON CORPORATE REGULATION

The interactive perspective on the federal-state relationship offers a promising approach for analyzing corporate governance problems. It suggests the need for a flexible and comprehensive view of corporate regulation—an approach unbounded by strictures imposed by federalism's imagined boundaries. Instead of hewing to the outmoded and unwieldy sphere of influence approach, we should view corporate and securities law as an integrated whole. Corporate and securities laws all aim to mitigate agency problems by curbing corporate managers' temptations toward negligence, self-dealing, and fraud.[127] Given these shared policy objectives, it is unsurprising that the matters addressed under each regime would overlap and converge.[128]

The integrated approach advanced here draws on the

122. *Id*. at 624.

123. *Id*.

124. *Id*. at 654-56.

125. *See* Robert M. Cover & T. Alexander Aleinikoff, *Dialectical Federalism: Habeas Corpus and the Court*, 86 YALE L.J. 1035, 1046-47 (1977).

126. Jones, *supra* note 4, at 130.

127. Prentice, *supra* note 89, at 1158.

128. *See* Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Laws*, 70 U. CIN. L. REV. 475, 476-77, 525-26 (2002) (describing the substantial overlap in subject matter under Rule 10b-5 fraud liability and state corporate law's fiduciary duty of candor).

developments in constitutional law in which scholars have challenged the re-emergent quest for protected spheres of state authority.[129] It reflects the fluidity of interaction between federal and state actors in corporate regulation over the past seventy years, and allows for continuing interaction between state and federal law which should increase the likelihood that effective policies will be adopted.

Sustained interaction between state and federal regulators improves the likelihood that government policies will reflect the public will and that such policies can be implemented effectively. Additionally, such sustained interaction helps facilitate democratic deliberation by accommodating more (and more varied) voices, creating tension that can spur political debate, and preserving multiple avenues of public appeal.

A. The Basic Outline

The integrated approach to corporate governance is not a reform proposal. Rather, it is a call to recognize the interactive system that actually exists. Under an integrated approach, Congress and state governments would all maintain their roles in shaping corporate governance policy. Most importantly, Congress would remain fully engaged and informed on issues in corporate governance, so that it is poised to act when necessary to address shortcomings in the existing legal regime. An integrated approach also suggests that the SEC should be afforded a wide berth for administrative action. Its administrative authority should be interpreted in a manner consistent with the broad language employed in the Exchange Act.[130]

Recognizing the SEC's authority to implement corporate governance reforms offers several advantages over a narrow construction of SEC authority. When compared to legislative action by Congress, SEC rulemaking can be a more flexible and nimble regulatory tool. SEC regulations can be amended and fine-tuned in response to new developments or economic crises. For example, the SEC responded in real-time to concerns arising from the Enron

129. *See supra* text accompanying notes 107-115.

130. *See, e.g.*, Exchange Act § 14(a), 15 U.S.C. § 78n(a) (2000) (authorizing the SEC to adopt proxy solicitation rules "as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors"); § 10(b), 15 U.S.C. § 78j(b) (2000 and Supp. III 2003) (authorizing the SEC to adopt such anti-fraud rules "as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors"); § 19(c), 15 U.S.C. § 78s(c) (2000) (discussed *supra* note 41, stating that the SEC may "abrogate, add to, and delete from . . . the rules of a self-regulatory organization . . . as the Commission deems necessary or appropriate . . . in furtherance of the purposes of [the Exchange Act]").

fraud and financial misconduct at other corporations. Months before Congress passed the Sarbanes-Oxley Act reforms, the SEC had begun to address investor confidence issues created by the accounting scandals.[131] When it enacted Sarbanes-Oxley, Congress codified many of the SEC's post-Enron regulations, implicitly approving the SEC's initial response.[132]

Another advantage to SEC rulemaking is that a miscalculation or error in an SEC rule or policy is easier to correct than a similar misstep embodied in a federal statute. Congress is slow to revisit legislation, especially when the concerns that prompted the legislation have moved off the regulatory agenda.[133] Major corporate reform legislation occurs only upon the confluence of a combination of political, economic, and social circumstances.[134] Given the rarity of political alignments conducive to national corporate governance legislation, it makes sense to authorize administrative agencies to respond to intermittent policy problems and crises.[135]

The current controversy regarding the costs and benefits of Sarbanes-Oxley's internal control reporting requirements illustrates why delegated rulemaking is sometimes preferable to fixed

131. In January 2002, the SEC issued interpretive releases on off-balance sheet financing and management's discussion and analysis to guide corporations and their accountants toward more transparent disclosures. *See* Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations, No. 33-8056 67 Fed. Reg. 3746-02 (2002), *available at* http://www.sec.gov/rules/other/33-8056.htm. Similarly, after the exposure of the WorldCom fraud in June 2002, the SEC issued an emergency order requiring senior executives at all large public corporations to certify to the accuracy and reliability of their companies' most recent financial statements. Order Requiring the Filing of Sworn Statements Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934, File No. 4-460 (June 27, 2002), *available at* http://www.sec.gov/rules/other/4-460.htm. The SEC also proposed new rules requiring senior executives to certify to the accuracy of all of their quarterly and annual reports, and to undertake reasonable measures to assure the adequacy of their companies' internal controls. Certification of Disclosure in Companies' Quarterly and Annual Reports, Exchange Act Release No. 34-46079, 67 Fed. Reg. 41877 (proposed June 20, 2002), *available at* http://www.sec.gov/rules/proposed/34-46079.htm.

132. *See* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 918 (2003). The existence of these and other SEC initiatives is one reason that some argue that Sarbanes-Oxley was mostly window dressing. *Id*. at 941-43.

133. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1600-02 (2005) (recommending sunset provisions for emergency legislation).

134. Bratton & McCahery, *supra* note 1, at 661.

135. *See generally* Jerry L. Mashaw, *Prodelegation: Why Administrators Should Make Political Decisions*, 1 J.L. ECON. & ORG. 81 (1985) (supporting broad delegation of administrative authority).

legislative mandates. Section 404 of Sarbanes-Oxley requires reporting companies to assess annually the effectiveness of their internal controls and requires the firms' auditors to attest to the accuracy of managements' reports.[136] Many corporations have complained about the high costs of § 404 compliance, especially for smaller companies.[137] In response to these complaints, an SEC Advisory Committee issued a controversial recommendation that the SEC exempt small public companies from some or all of § 404's requirements.[138] The SEC rejected the Committee's recommendation, and instead delayed further the § 404 compliance deadline for smaller companies.

Had Congress delegated the task of specifying the scope and breadth of internal control reporting requirements to the SEC, the SEC could have better balanced the interests in greater financial transparency and accuracy against the proportionately higher costs of internal control assessments and audits for smaller companies. The SEC's notice and comment procedures and its required cost-benefit analyses provide safeguards not required as part of the legislative process.[139] Although the SEC may be able to soften the impact of § 404 through its exemptive authority, its discretion is limited by the requirements of the statute.[140]

The SEC's rulemaking procedures also protect important democratic values.[141] Under the Administrative Procedure Act, its

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136. 15 U.S.C. § 7262. *See* Rachel McTague, *SEC Advisory Panel Votes on Final Report; Section 404 Relief Advised, With Dissents*, 21 CORP. COUNS. WKLY. 129, 129 (2006).

137. U.S. GOV'T. ACCOUNTABILITY OFFICE, GAO 06-361, REPORT TO THE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP, U.S. SENATE, SARBANES-OXLEY ACT: CONSIDERATION OF KEY PRINCIPLES NEEDED IN ADDRESSING IMPLEMENTATION FOR SMALLER PUBLIC COMPANIES 4-5 (2006), *available at* http://www.gao.gov/new.items/d06361.pdf.

138. McTague, *supra* note 136, at 129.

139. *See supra and infra* text accompanying notes 138-40.

140. Some advocates maintain that the SEC lacks exemptive authority to adopt the Advisory Committee's recommendations. *See* Rachel McTague, *AARP Urges SEC, PCAOB to Reject Broad Exemption*, 21 CORP. COUNS. WKLY. 109, 109 (2006). Consider also that Congress failed to reconsider the PSLRA despite strong criticism of the heightened pleading standards and discovery stay, and charges that its limitations on shareholder litigation played a role in the rampant financial reporting abuses by corporate managers. *See, e.g.,* John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 288-91 (2004); Cunningham, *supra* note 132, at 921-22.

141. Joan MacLeod Heminway, *Rock, Paper, Scissors: Choosing the Right Vehicle for Federal Corporate Governance Initiatives*, 10 FORDHAM J. CORP. & FIN. L. 225, 275 (2005) (describing the SEC's deliberative rulemaking process).

regulatory proposals are subject to extensive public comment.[142] The comment process assures an opportunity for interested parties to debate and criticize proposed regulations. The rulemaking process also allows ordinary citizens and a wide range of interest groups to voice their concerns to the SEC.[143]

Although protective of a robust federal role in corporate governance, an integrated perspective on corporate governance also cautions against ready preemption of state law. Due to our political history, states have developed an extensive system of statutory and common law. As long as state laws do not conflict with the national interest, such laws should be respected. Federal preemption may be warranted when there is a clear need for policy coordination that cannot be achieved through uniform laws.[144] However, when undertaken, such preemption should be limited in scope.

Under such an analysis, legislation such as NSMIA can be justified. The states tried and failed to coordinate exemptions from securities registration requirements with the SEC.[145] Strong arguments were advanced for the need for uniformity for nationwide securities offerings.[146] In contrast, the arguments for preemption of state securities fraud claims are less persuasive. Uniform standards exist at the state and federal levels prohibiting fraud in securities transactions. The federal courts have construed the elements of a Rule 10b-5 to accord with state common law fraud standards. Moreover, forty states have adopted some version of the Uniform Securities Act which includes anti-fraud provisions patterned on federal law.[147] Variations that do exist among states and between state and federal officials relate mainly to enforcement practices and procedures. Thus, although corporations and stock promoters are guided by consistent standards of conduct in securities transactions, the prospect of liability for violating such standards can vary significantly from one jurisdiction to another. Those who argue for

142. Pub. L. No. 79-404, 60 Stat. 237 (codified at 5 U.S.C. §§ 551-59, 701-06 and other scattered sections of Title 5).

143. *See* Mariano-Florentino Cuéllar, *Rethinking Regulatory Democracy*, 57 ADMIN. L. REV. 411, 429 (2005) (discussing the influence of public comments on rulemaking by administrative agencies); Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1, 27 (1997) (arguing that public participation in agency rule making has an independent democratic value).

144. *See* SHAPIRO, *supra* note 91, at 119-20.

145. *See supra* text accompanying notes 65-68.

146. *See* Painter, *supra* note 7, at 60.

147. LOUIS LOSS & JOEL SELIGMAN, I SECURITIES REGULATION 42 (3d ed. 1998); LOUIS LOSS & JOEL SELIGMAN, IX SECURITIES REGULATION 4126-40 (3d ed. 2004).

preemption of states' enforcement powers seem to be seeking uniformity in *forbearance* from enforcement, rather than the uniform application of fraud standards.

B. Advantages

An integrated corporate governance system that equally engages federal and state authorities offers a number of advantages over the stilted sphere of influence approach that dominates corporate law theory. The integrated perspective is more respectful of democratic principles and can help facilitate more productive policy discussions.

1. Politics and Democracy

Interactive federalism enhances opportunities for public participation in the development of corporate law policy and broadens citizens' access to policymakers. An essential component to maintaining a legitimate democracy is broad public participation in policy debates.[148] Broad political participation creates demands for regulators and reform advocates to give reasons for their favored policies and allows citizens to challenge those rules, policies, and official actions that affect their lives.[149]

The varying governance structures that exist at the state and federal levels provide state and national officials with different sets of motivations in developing policies. At a given point in time, state and federal officials (and officials in different states) will have incentives to respond differently to various constituency groups. Consider the example of corporation statutes. The undemocratic nature of state corporate lawmaking is legendary.[150] State corporation statutes are drafted by corporate lawyers acting on behalf of their business clients under the aegis of local bar associations.[151] These statutes are typically drafted with minimal input from representatives of any constituencies other than

148. *See, e.g.*, AMY GUTMANN & DENNIS THOMPSON, WHY DELIBERATIVE DEMOCRACY? 29-30 (2004); CASS R. SUNSTEIN, THE PARTIAL CONSTITUTION 134 (1993). For a critique of deliberative democracy theory, see Christopher H. Schroeder, *Deliberative Democracy's Attempt to Turn Politics into Law*, 65 LAW & CONTEMP. PROBS. 95 (2002).

149. GUTMANN & THOMPSON, *supra* note 148, at 101-02, 135.

150. Daniel J.H. Greenwood, *Democracy and Delaware: The Puzzle of Corporate Law* 1 (George Washington Univ. Law Sch., Pub. Law & Legal Theory Working Paper No. 55, 2003), *available at* http://ssrn.com/abstract=363480 (last visited June 8, 2006).

151. Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 920 (1990).

corporate managers and corporation service companies.[152]

By contrast, federal legislative and rulemaking processes encompass a broader range of citizen voices. Of course, national politicians are subject to considerable influence from interest groups, but they are also accountable to the citizens they represent, and they risk replacement if they are perceived to ignore voters' most salient concerns.[153] The policy perspectives represented in the national legislative processes are more inclusive than those that hold sway at the state level. In congressional hearings on major reform bills, Congress hears testimony from academics, lobbyists, and government officials who provide competing perspectives on the proposed legislation.[154]

Historically, shareholder interests do not always fare well at the national level, but the viewpoints of shareholder advocates are well articulated and have tended to moderate the more extreme legislative provisions proposed. For example, the initial versions of the PSLRA, NSMIA, and SLUSA were revised significantly to remove some of the more extreme provisions that proponents of the reforms had sought.[155]

Although national policymaking processes are more inclusive than the states' processes, the risk of interest group dominance remains high. For example, the accounting and high-tech industries effectively controlled and constrained the regulatory agendas of Congress, the SEC, and FASB during the 1990s. Through this influence, industry trade groups secured the passage of preemptive legislation and also quashed SEC initiatives to enhance auditor independence and to require the expensing of employee stock options.[156]

An integrated system for corporate regulation, in which both federal and state regulators play active roles should help to alleviate risks of regulatory capture and improve the prospect that laws will

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152. *See* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 506-09 (1987); Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 868 (1969).

153. *See* Bratton & McCahery, *supra* note 1, at 635; Romano, *supra* note 133, at 1524-25.

154. *See* Jones, *supra* note 17, at 636-37 n.67; Painter, *supra* note 7, at 19.

155. Bratton & McCahery, *supra* note 1, at 672-73. For example, early versions of the PSLRA included a "loser pays" rule that would require plaintiffs to pay the defendants' costs if they lost their case. *See* Republican Contract with America, http://www.house.gov/house/Contract/CONTRACT.html (last visited June 8, 2006) (describing the Common Sense Legal Standards Reform Act of 1995, H.R. 956, 104th Cong. (1995)); NAGY ET AL., *supra* note 69, at 416.

156. *See* LEVITT, *supra* note 76, at 240-43.

reasonably reflect public values.[157] The independent power of state authorities serves as a counterweight to the power of federal regulators and vice-versa. Increased federal intervention in corporate regulation ensures that "two governmental hierarchies will be involved in a particular area of governance instead of one," increasing the diffusion of government power.[158] Protecting state sovereignty in securities enforcement offers a comparable benefit in the securities field.[159]

2. Streamlining Debate

An integrated perspective on corporate regulation can also serve as a brush-clearing mechanism in the corporate law literature. This perspective holds the promise of liberating corporate scholarship from the sphere of influence mentality, creating space for more fruitful discussions of the policy options our nation confronts. An explicit recognition of how federalism arguments distort policy discussions should inspire greater reticence among academics to engage in policy debates premised on the sphere of influence framework.

An integrated approach suggests a straightforward manner for addressing corporate policy problems. Take a simple paradigm for the progression of policy discussions among a collective of policymakers and advocates. Such a discussion would proceed through three stages: diagnosis, prescription, and implementation. The first step is the diagnostic stage—identifying the problem. The prescriptive stage entails developing policy proposals to address the problems identified, and the implementation stage concerns strategies for implementing the agreed-upon reforms.

At the prescriptive stage of debate, questions regarding the appropriateness of regulatory intervention should be addressed. Proponents of market-solutions or self-regulation have space within the prescriptive stage to advance arguments against government action. Participants in the prescriptive discussions would consider various regulatory approaches to addressing the problem. Those who agree that legal reform is warranted would work to develop solutions to the problems identified.

Once competing policy approaches and proposals have been

157. SHAPIRO, *supra* note 91, at 80-81.

158. Rubin & Feeley, *supra* note 87, at 933-34 ("The second decision-maker can introduce new standards, subject old ones to debate, increase popular awareness, decrease arbitrary power, restrain corruption and thereby expand liberty—the liberty of individuals from excessive or inappropriate government control.").

159. *See supra* notes 73-79 and accompanying text; Jones, *supra* note 4, at 123-25.

fully considered, reform proponents should consider strategies for implementing needed reforms. At the implementation stage, the discussions would analyze whether it is best to seek reform at the national level or whether states should be encouraged to implement reforms. As part of this analysis it is proper to weigh considerations of history and tradition, political concerns, externalities, and administrative competence.[160] These considerations should be taken against a backdrop expectation of cooperation among federal and state officials in implementing policies that result from a democratic decisionmaking process.

Those who deny that problems exist or who resist regulatory solutions have little to contribute in the implementation phase of policy discussions. Therefore, their efforts to participate in implementation debates can fairly be viewed as attempts to thwart implementation of proposals developed at the prescriptive stage. Certainly, valid objections can be raised that challenge the conclusions reached at diagnostic and prescriptive stages, but these arguments should be articulated and understood as such. When those who dispute the diagnostic or prescriptive conclusions seek to dominate the debate at the implementation stage, policymakers and commentators should recognize this move and engage those arguments only on terms appropriate to the diagnostic or prescriptive questions.

To illustrate, many commentators have criticized the Sarbanes-Oxley Act that Congress adopted in response to the Enron and WorldCom scandals. Sarbanes-Oxley's critics charge alternatively that the Act was unnecessary, hastily drawn, ineffective, or harmful.[161] Some focus their objections on the fact that the Act was adopted by Congress, and traditionally corporate governance is the province of the states.[162] This federalization argument against Sarbanes-Oxley posits that because Congress has not so directly regulated corporate governance in the past, it should not begin to do so now. Under this analysis, Congress cannot fix the legislation; it can only repeal it.[163] Of course, these critics' core objection to Sarbanes-Oxley is to its substantive provisions rather than its provenance.[164] Yet, the terms in which they frame the argument

160. Heminway, *supra* note 141, at 228 (encouraging "an analytical, comparative approach to institutional choice" in the establishment of corporate governance rules).

161. *See, e.g.*, Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 61 (2002).

162. Bainbridge, *supra* note 2, at 27-28; *Id.*

163. Ahdieh, *supra* note 7, at 731-32.

164. *See* Ribstein, *supra* note 161, at 61.

deflect a direct response to its deregulatory moorings.

C. Challenges

Once we accept the overlap of federal and state authority in corporate affairs as legitimate, an important and neglected question is how best to manage the challenges that come with maintaining a system of concurrent jurisdiction. A number of objections can be raised to efforts to maintain redundant layers of authority to govern corporate conduct.

1. Preserving State Autonomy

One problem to be tackled is determining how conflicts between federal and state policy should be resolved. Proponents of interactive federalism welcome the reality that national policy will sometimes conflict with a state's approach. When conflicts arise between policies of the national government and that of one or more states, they can stimulate a public debate that allows citizens to play a role in resolving the conflict.[165] Because local and national politicians alike are accountable to the public, a debate on the merits of a contested state or federal policy affords citizens the opportunity to air their views and express their preferences to politicians at all levels of government.

However, federalism proponents are less sanguine about the expected outcome of conflicts between state and federal authorities. Such federalists often complain that the supremacy clause inevitably stacks the deck in favor of the central authority.[166] Congress can use its preemptive powers to deprive citizens of the protection of a second level of government to hear their appeals. If federalism is abandoned as a constraining principle, federalists ask, what mechanisms will protect states and their citizens from the vast expansive powers of the central government?[167]

The reality is hardly as bleak as federalists would suggest. Despite the dramatic expansion of federal power over the centuries, states continue to exercise considerable regulatory authority. For whatever reasons, the political safeguards of federalism or the strength of political parties, the growth of the federal government

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165. Todd E. Pettys, *Competing for the People's Affection*: *Federalism's Forgotten Marketplace*, 56 VAND. L. REV. 329, 390 (2003).

166. *See* Hamilton, *supra* note 96, at 1078.

167. *See id.* ("Congress holds the trump card of preemption, a larger purse and ready access to the national media."); Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and "Dual Sovereignty" Doesn't*, 96 MICH. L. REV. 813, 824 (1998) ("[W]hat good is the preservation of state administrative autonomy, if the states are not guaranteed some area of subject matter jurisdiction in which to exercise it?").

has not significantly altered the prime role of state and local governments in the lives of individual citizens.[168]

2. Avoiding Inefficiencies

A second objection to maintaining redundant authority is that inefficiencies are created by requiring businesses to deal with varying regulatory standards at the federal level and in all fifty states. Congress, therefore, should not be discouraged from preempting state laws to extricate industry from the burdens of excessive regulation.

This concern, although real, is often overstated. Through restatements of law, uniform laws, and similar coordination efforts, states frequently harmonize their laws to minimize regulatory disarray. Furthermore, such tension is an unavoidable consequence of maintaining the very governance structure that federalists champion. Despite underlying tension, federal and state regulators have demonstrated the ability to work together in many areas of concurrent jurisdiction including crime, health and safety, and the environment.[169] In securities enforcement, for example, despite clashing egos and differing policy perspectives, Attorney General Spitzer and officials from other states found ways to coordinate policies and practices with the SEC and the Department of Justice.[170]

CONCLUSION

Traditional federalism concepts contribute little to our understanding of how best to address our nation's corporate governance problems. Federalism values have been invoked inconsistently in discussions of allocation of authority—supporting state power in corporate law and quietly abiding the trampling of such power in securities regulation. It seems, therefore, that many federalism arguments are merely deregulatory arguments in disguise. However, because these deregulatory arguments are couched in federalism terms, they serve mainly to distract from important substantive debates on whether and how to best regulate American corporations.

168. *See* SHAPIRO, *supra* note 91, at 114 ("[A] remarkable proportion of the regulations that affect our daily lives . . . continue as primarily the subject of state and local control."); Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215, 220 (2000) ("[A] striking fact about government in the United States is how much authority is still exercised at the state and local level.").

169. Jones, *supra* note 4, at 130.

170. *Id.* at 119, 121.

An interactive approach to corporate regulation provides a better lens through which to evaluate corporate governance policy. It provides a more democratic framework for developing corporate governance policy and can help free policy discussions from the distractions created by confusing and ultimately hollow distinctions between corporate and securities law.