Federalism in Corporate/Securities Law: Reflections on Delaware, California, and State Regulation of Insider Trading

By DONALD C. LANGEVOORT*

THE "FEDERALISM QUESTION" in corporate and securities law—that is, the proper dividing line between federal and state competencies in this field—has caused significant jurisdictional skirmishing for nearly a century. There were vigorous debates as to whether (and how far) the federal government ought to intervene before Congress chose to act in the early 1930s, and ever since, arguments about the nature and limits on the federal presence, via the Securities and Exchange Commission ("SEC" or "Commission"), have persisted. Just as heated have been the questions about the proper scope of state power to regulate the securities markets and the securities industry—state anti-takeover legislation in the 1970s and '80s being but the most visible of the issues that generated sustained judicial attention.[1]

Recently, both forms of the question have drawn renewed public attention. By all accounts, the Sarbanes-Oxley Act ("Sarbanes-Oxley") has federalized more of what Congress used to leave to state corporate law. While no doubts exist about the constitutional power of Congress to regulate as broadly as it wants, some have certainly questioned the wisdom of it doing so (not to mention the substance of the new regulation).[2] The SEC's proposed rule to enlarge shareholder access to the corporate ballot also engendered strong criticism on both legal and policy grounds, and this criticism effectively derailed it. Conversely, state activism in marketplace regulation surged in the last few

* Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center. An excellent paper by one of my seminar students elaborates on Delaware's insider trading jurisprudence. *See* Lauren Reynolds, *Delaware's Sacrifice: The End of the Brophy Doctrine* (2005) (on file with the author).

1. *See, e.g.*, CTS Corp. v. Dynamics Corp., 481 U.S. 69 (1987); Edgar v. MITE Corp., 457 U.S. 624 (1982).

2. *See, e.g.*, Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1529 (2005).

years, marked by the efforts of Eliot Spitzer of New York and other state regulators in such areas as mutual fund behavior and investment analyst conflicts. That activism also triggered a strong counter-reaction, including legislative efforts to get Congress to reign in the states.

These events have renewed a debate both political and intellectual. Important scholars have long made the federalism issue a central focus of their work. Louis Loss, William Cary, and others sought to justify more federal power in the corporate arena—an argument that held sway in intellectual circles until others launched a strong economics-driven counterattack in the 1970s. Over the next two decades, the pendulum swung in the direction of fervent celebration of state primacy because of the benefits state competition for charters generated.[3]

Today the intellectual debate is far less one-sided, as I shall explain. Although critics of federal government intervention in the field of corporate law still have a strong voice through influential scholars such as Roberta Romano, Steve Choi, Larry Ribstein, and Steve Bainbridge, many others have questioned the virtue—even the existence—of real state competition for charters[4] and have made the case for stronger federal protection of shareholder rights.[5] In a remarkable set of articles in the *Harvard Law Review*, Mark Roe has declared that, while state competition might have occurred at one time, any "race" is now over.[6] Delaware has won, in terms of public corporations at least, and has monopoly-like power. The federal government presents its only true (and still largely potential) competition.

In this brief Essay, I offer some thoughts on both the theory and the politics underlying the federalism question. My comments will touch on some of the controversies and also look at a somewhat quieter question, the state regulation of insider trading. Over the course of the last few years, judges in California and Delaware have traveled markedly different routes on questions involving the states' role in regulating insider trading. A California court of appeal has recently expanded the reach of the state insider trading statute to cover a

3. *See* FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW vii, 5–6, 212–15 (1991) (noting that corporate law has an economic structure and doubting that state competition may be a "race for the bottom").

4. *See, e.g.*, Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002).

5. *See* Lucian Bebchuk, *The Case For Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005).

6. *See* Mark Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 590 (2003); Mark Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2493 (2005).

claim alleging misconduct in California by an executive of a Delaware-chartered company.[7] By contrast, Delaware Vice-Chancellor Leo Strine has hinted strongly that Delaware courts should consider getting out of the business of regulating insider trading entirely,[8] notwithstanding a venerable old Delaware case long cited for the proposition that insider trading naturally breaches the fiduciary duty of loyalty.[9] These contrasting approaches make a nice pair from which to think through the federalism question free from the blinding glare of controversy surrounding Eliot Spitzer, the shareholder ballot access proposal, or Sarbanes-Oxley.

I. The Fundamentals: State "Primacy" as a Federal Choice

Some commentators employ a rhetorical trick by speaking of federal "incursions" on state primacy in corporate internal affairs. Constitutionally, the federal government has the supreme authority on all matters of interstate commerce, which certainly includes the field of public company regulation. Whatever authority the states have over public corporations comes from their historic role in chartering (and thus regulating to some extent) corporate internal affairs, which Congress has chosen to accept. Only federal acquiescence prevents a change in roles—Congress could at any time pre-empt the field, wholly or partially. Implicitly, state authority in this area extends only so far as Congress wishes it to.

Congress has plainly elected to allow the states to retain primary authority on matters of corporate structure, governance, and fiduciary responsibilities. Congress also allows state "blue sky" securities regulation within limits that it seriously tightened in 1996.[10] However, there is a strong federal presence largely in the form of rulemaking by the SEC and the national stock exchanges. These bodies perform the role of federal self-regulatory organizations.[11]

7. Friese v. Superior Court, 36 Cal. Rptr. 3d. 558, 563–568 (Cal. Ct. App. 2005).

8. Strine stated his position most notably in a case that also happened to involve a California-based company incorporated in Delaware. *See In re* Oracle Corp., 867 A.2d 904, 930–936 (Del. Ch. 2004).

9. Brophy v. Cities Serv. Co., 70 A.2d 5 (Del. Ch. 1949).

10. Congress tightened the limits on "blue sky" securities regulation under the National Securities Markets Improvement Act. *See* Rutherford B. Campbell, *The Insidious Remnants of State Rules Respecting Capital Formation*, 78 WASH. U. L.Q. 407, 407 (2000).

11. *See* articles cited *supra* note 6. *See, e.g.*, Robert Ahdieh, *From "Federalization" to "Mixed Governance" in Corporate Law: A Defense of Sarbanes-Oxley*, 53 BUFF. L. REV. 721 (2005); Renee Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625 (2004).

Considerable overlap takes place in the field of proxy regulation because, as originally enacted, the legislative history of section 14(a) consists mainly of generalizations and does not point strongly one way or the other on the question of authority.[12] Most of what one can unearth in the statute relates to disclosure. Congress noted that "[t]oo often proxies are solicited without explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought,"[13] and it plainly saw the heavy veil of secrecy as a main source of abuse. But the committee reports hint at broader authority for the SEC. Over the past forty years, courts have invoked this language in all of their major judicial decisions that address the proxy area. These include expressions that "fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange."[14] They illustrate Congress's desire to "control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which . . . had frustrated the free exercise of the voting rights of stockholders."[15] These quotes hardly suggest that Congress draws the line strictly at disclosure; rather, they indicate that the government has much more work to do at the federal level to protect investors.

The same rings true with respect to another supposed "restriction"—that federal securities law limits itself to disclosure and transparency, leaving corporate mismanagement and fiduciary responsibilities wholly to state control. As I have shown elsewhere,[16] what Congress could accomplish on matters within the realm of disclosure and transparency almost co-extends with the substantive regulation in the first place. The going private phenomenon of the 1970s and '80s serves to illustrate this point. *Santa Fe Industries v. Green*[17] is the landmark citation for a federalism-driven vision of separate spheres of authority. In that case, the Supreme Court held that simple breaches of fiduciary duty, which occur as part of corporate freeze-outs, are outside the reach of Rule 10b-5.[18] The Court stated in dicta that the issue was something rightly left to the states.[19] But within a

12. 17 C.F.R. § 240.14a (2006).

13. S. Rep. No. 73-792, at 12 (1934).

14. H.R. Rep. No. 73-1383, at 13 (1934).

15. *Id.* at 14.

16. Donald C. Langevoort, *Seeking Sunlight in Santa Fe's Shadow: The SEC's Pursuit of Managerial Accountability*, 79 WASH. U. L.Q. 449, 487 (2001).

17. 430 U.S. 462 (1977).

18. *Id.* at 473–74; 17 C.F.R. § 240.10b-5 (2006).

19. *Id.* at 478–79.

few years the SEC adopted a disclosure rule, 13e-3, requiring any freeze-out transaction to include a disclosure document explaining why the transaction treats investors fairly.[20] Obviously, one cannot describe any unfair transaction as fair so any overreaching easily becomes a 13e-3 violation.[21] One can find similar patterns throughout the substance of federal regulation.[22] Congress knows it and has for a long time.

The interesting question, then, is not why the United States has so much federal law, but why we tolerate so much state authority over public corporations. After all, there is the problem of democratic legitimacy. Certainly, no political theories can justify the power Delaware courts and legislators have over the world-wide activities of a substantial majority of the country's public corporations, unless one believes that corporations are simply a private consensual arrangement between shareholders and managers. So, why does Congress leave the states any room in this area at all, whatever the extent of the federal overlay?

Many academics would answer that Congress does so out of wisdom—introducing state-level regulatory competition arguably improves the quality of the product over what a monopolist federal regulator would produce. I certainly do not want to repeat the vast literature on this question. Suffice it to say that many commentators in the literature today hold a strong view that only "leisurely" competition, if any, takes place among the states.[23] To be sure, Delaware could lose its incorporation business by regulating abysmally, but it need not consume itself with worry either. Congress still tolerates a large state presence, including Delaware's primacy.

Mark Roe posits an intriguing idea; he argues that Congress has made a strategic, savvy, and implicit political choice at the federal level. Two interest groups—managers and investors—have the largest mutual interest in matters of corporate and securities laws, and one might expect them to compete with each other for dominance. But, by all accounts, efficiency concerns require compromise; investors will

20. 17 C.F.R. § 240.13e-3 (2006).

21. *See* Ralph Ferrara & Marc Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263, 273, n.49 (1980).

22. A fairly dramatic demonstration is the relative balance in litigation between federal and state claims regarding fiduciary obligation. *See* Robert Thompson & Hillary Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 909–10 (2003).

23. *See, e.g.*, Lucian Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk?: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 555 (2002).

not realize decent returns without granting managers a substantial level of entrepreneurial autonomy, and managers will not gain access to capital without credibly committing to some investor protection. In purely political terms, one would expect the law—wherever it is produced—to mainly reflect these interests, with managers probably having the advantage on close questions because they are less dispersed and more organized.

So why then delegate this task to the states? Roe suggests that both managers and the major suppliers of capital—who agree that profitability should be the proper goal of the firm—recognize that others may interfere with their negotiations.[24] Those other stakeholders may hold profitability secondary in importance to something else.[25] Labor presents itself as one organized source of interference, as do more diffuse populist voices. These interests rarely have the power to compete effectively and gain political strength, except in times of economic troubles or scandal. But periodically, troubles and scandals do occur. To the extent that corporate regulation exists as an entirely federal scheme, managers and investors always run the risk that current events will upset their negotiations.

What managers and investors likely want then, is to place corporate regulation in a place removed as far as possible from this political risk.[26] Delaware plays the role perfectly. The state shows little interest except in maintaining its incorporation and legal services revenue, and it certainly does not display an inclination toward populist sentiment. Delaware can comfortably concentrate on balancing manager-investor interests in the name of corporate profitability so long as it keeps in mind two simple imperatives: first, do not alienate either manager or investor interests so that their frustrations cause them to seek political alliances elsewhere; second, do not alienate Congress so that it takes over the jurisdiction. One can understand much of Delaware corporate law as the product of this strategy.[27]

24. *See* articles cited *supra* note 6.

25. *See, e.g.*, David Westbrook, *Corporation Law After Enron: The Possibility of a Capitalist Reimagination*, 92 GEO. L.J. 61, 108–10 (2003) (recognizing that corporate law has a public rather than private character).

26. Obviously, the scandals or troubles could be strong enough that Congress simply federalizes the entirety of the law. But that is a daunting task because it involves regulating a great deal of new territory. In other words, the harder this task, the less likely it is to happen.

27. For a similar claim, see Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1588–89 (2005).

There are, of course, forty-nine other states, plus the District of Columbia and the territories. Some other states might have performed the function, but Delaware took the lead early on and developed a deep corporate law regime that now gives it an un-erodable advantage. Other large states like New York, Illinois, and California retain some domestic public corporations, but they have a tenuous grip on them—reincorporation elsewhere presents few obstacles so long as the directors and shareholders agree. However, these states have political dynamics much like the federal government, where troubles and scandals can lead to public claims of corporate accountability at the expense of maximizing profit. Congress has no reason to cede control over corporate governance to these states. Only the availability of a special situation like Delaware (or a Delaware political equivalent) makes feasible the federalist arrangement that Congress has chosen.

This story, of course, specifically focuses on corporate law. Securities regulation operates somewhat differently, although one can understand it in light of the same set of ideas. In 1933 and 1934, Congress did choose to federalize securities regulation.[28] The exercise plainly reflects an odd political moment: the stock market crash of 1929, the Pecora hearings in Congress, and the onset of the Great Depression all coincided, allowing populist sentiment in favor of transparency and against manipulation (and more) to produce legislation that certainly would not otherwise have occurred—in anything resembling that form, at least.

Whatever the political motivations, the legislation produced a two-fold jurisdictional effect. First, it created a counterweight to state corporate law that made the threat of incursion into areas of governance and fiduciary responsibility more palpable, setting in motion the creative tension that Roe describes: the threat of federal regulation as "Delaware's Competition."[29] Second, it created greater democratic legitimacy because something approximating concurrent jurisdiction emerged; the federal government took a role in the regulation of interstate corporate behavior that made the posture of deference to the states less jarring.

As to state securities regulation, Congress made an explicit choice. It put savings clauses in the securities acts that authorized con-

28. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2000)); Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78mm (2000)).

29. *See* articles cited *supra* note 6.

currency absent actual conflict. By doing so, Congress specifically recognized the virtue of leaving states free to regulate small business matters and to continue their practice of passing on registered public offerings to local residents. That specific authority saved the state laws from Supremacy Clause invalidity. In 1996, as noted earlier, Congress cut back considerably on the permissible scope of state regulation of the offering process, but it left state enforcement efforts alone.

We will return later to some of the bigger controversies that arise out of this political choice. For now, it might be interesting to look at a much quieter issue—the proper scope of state insider-trading regulation.

II. State Insider Trading Regulation: Delaware Versus California

California regulates insider trading by statute in its corporate securities law.[30] Section 25402 bars insider trading by the issuer or by officers and by directors or by controlling shareholders;[31] section 25502.5 creates a derivative cause of action to seek disgorgement of insider trading profits.[32]

The question posed in *Friese v. Superior Court*[33] was essentially whether courts should construe the statute as corporate or securities law.[34] If the former, then the statute would only apply to firms incorporated in California, not to the trading at issue in *Friese*. The case involved a San Diego-based corporation, Peregrine Systems Inc., that was incorporated in Delaware.[35] The trial court treated the statute as corporate law and dismissed the complaint; the court of appeal reversed and reinstated the claim.[36]

By contrast, Delaware treats insider trading as a breach of fiduciary duty, which makes it a matter of judicial rather than statutory interpretation. A 1949 decision of the Chancery Court, *Brophy v. Cities Service Co.*,[37] recognized a derivative cause of action to recover insider trading profits, and that decision stood as an oft-cited (albeit infrequently applied) expression of Delaware law in the decades that fol-

30. *See* Don Berger, *Issuer Recovery of Insider Trading Profits Under Section 25502.5 of the California Corporation Code*, 21 PAC. L.J. 221 (1990).

31. Cal. Corp. Code § 25402 (West 2006).

32. Cal. Corp. Code § 25502.5 (West 2006).

33. 36 Cal. Rptr. 3d 558 (Cal. Ct. App. 2005).

34. *Id.* at 571.

35. *Id.* at 561-62.

36. *Id.* at 561.

37. 70 A.2d 5 (Del. Ch. 1949).

lowed. In the last couple of years, however, Vice-Chancellor Leo Strine has written a series of opinions—most recently in *In re Oracle Corp.*[38]—asking whether *Brophy* is still good law and signaling the possibility that Delaware might abandon the field. Strine's main point is that now (as opposed to when *Brophy* was decided) the federal government thoroughly regulates insider trading so that state intervention creates potential for duplicative efforts, at best, and inconsistency and conflict, at worst.[39]

The California and Delaware cases juxtapose nicely, one aggressively expansionist, the other extraordinarily restrained. What is going on here? As to the California statute, the text of the statute certainly does not limit its jurisdictional reach to companies incorporated in California. Nonetheless, I think the trial court's holding in *Friese* makes more sense.[40] To agree with me, one must understand what insider trading regulation is really all about. Courts and commentators who have thought deeply about insider trading see that it really has very little resemblance to "fraud in the inducement" and other common bases for fraud liability. It causes no reliance or any individualized injury. When federal courts call it fraud, their actions obscure the justification for insider trading regulation, which takes a very different tone. Insider trading can cause harm to a corporation (threatening secrecy). It can also widen bid-ask spreads in the market (raising the cost of capital).[41] Finally—and more controversially—it can dampen investors' willingness to invest as a matter of economic culture. Each justification provides a plausible reason to discourage insider trading by making it unlawful, but calling it fraud is a sleight of hand, a convenient result-oriented way of getting to the right result notwithstanding the absence of specific federal statutory authority.[42]

38. 867 A.2d 904 (Del. Ch. 2004). *See also* Guttman v. Huang, 823 A.2d 492 (Del. Ch. 2003).

39. *See* Freeman v. Decio, 584 F.2d 186 (7th Cir. 1978) (Indiana law). In *In re Oracle*, Vice-Chancellor Strine does not reach the issue because he finds insufficient evidence of insider trading in terms of actual misuse of information. 867 A.2d at 907. One curious feature of the opinion is the assumption that the plaintiff has to show that the possession of the information caused the insider to trade in order to avoid a conflict with the scienter requirement under federal law. The SEC, however, has established, via Rule 10b5-1, that misuse is not the test; mere possession is. 17 C.F.R. § 240.10b5-1 (2006).

40. *See also In re* Sagent Technology Inc., 278 F. Supp. 2d 1079 (N.D. Cal. 2003).

41. For the best collection and evaluation of arguments for and against insider trading regulation see ROBERT C. CLARK, CORPORATE LAW 274–75 (1986).

42. *See* Donald Langevoort, *Rereading Cady, Roberts: The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319, 1337 (1999).

For example, consider a case where insider trading occurs in California with respect to shares of a Delaware corporation like Peregrine. California's jurisdiction, as a matter of "securities regulation," would have more clarity if some identifiable injury to California investors existed. But as noted above, that does not occur with insider trading; the marketplace harms are too diffuse. Further, the kinds of harms that might come to the corporation increasingly resemble others that occur when insiders place their interests above their employers' interests—but that sits squarely within the realm of corporate law.

California might still find that when conduct occurs in California, the conduct entitles it to regulate regardless of where one feels the harm or how one feels it, which is true. I do not argue that California could not permissibly proscribe the kind of behavior alleged at Peregrine, rather, I assert that it is being aggressive. In so doing, California addresses a space already occupied by the federal government. Given the ambiguity in the statute, I am not sure that California's courts should take such an aggressive stance without stronger evidence of legislative intent.[43]

I react to Vice-Chancellor Strine's suggestion that Delaware abandon insider trading entirely in just the opposite fashion. To be sure, the SEC (with congressional endorsement) has thoroughly regulated insider trading as a form of fraud, presumably for the market-based reasons described above as well as its own political agenda. But the SEC engages in blunt regulation of a "bad act," not careful policy engineering. Thus, it remains hard to imagine that a state would interfere with the scheme by pushing harder.

In fact, many scholars who have looked at insider trading have concluded that state corporate law has a better claim to the regulation of insider trading than the securities laws do.[44] Corporate property-based rationales for restricting insider trading, which would normally be the province of state law, have a strong theoretical basis, even though a federal scheme of surveillance and detection would engender efficiency advantages. In principle, it remains hard to see why the

43. The statute is particularly corporate law-like in two respects. First, the primary enforcement mechanism is a derivative suit. Second, it is limited to trading by officers, directors and large shareholders—the main kinds of fiduciaries under corporate law. Any harm to the market that flows from insider trading has nothing to do with the status of the trader. *See supra* notes 30–31 and accompanying text.

44. *See, e.g.*, Stephen Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. Rev. 1589, 1596 (1999) (recognizing that perhaps states have the better claim to regulating insider trading, but that federal regulation has occupied the field).

mere presence of federal regulation should call an otherwise valid state claim into question, much less cause a state judge to preemptively abandon it. As noted earlier, concurrent jurisdiction increasingly has become the order of the day.

So what is the Vice-Chancellor—otherwise such a strong proponent and craftsman of Delaware's primacy in corporate law—seeking to accomplish? Roe's thesis suggests an answer. Recall that Delaware has a compelling interest in having Congress acquiesce and leave the most fundamental matters of corporate law to the states, a posture that seemed at risk in the aftermath of the financial scandals. In response, Delaware judges became increasingly vocal and argued for the historic division of responsibility to continue, hoping to avoid the risk of confusion from too great an overlap.[45] Ceding insider trading to exclusive federal regulation is a diplomatic way of saying—mainly to the SEC—that each side should stay out of the other's primary responsibilities as much as possible. The implication is that the SEC ought to reciprocate on the fundamentals of corporate law.

That theory, to me, explains Delaware. In turn, one can only understand California's assertiveness as the opposite side of the coin. When California regulates insider trading without a distinctive or individualized harm felt there, it smacks of populism, an appeal that still has resonance even as the financial scandals recede in memory. One does not see that type of action from Delaware, which has implicitly promised management and organized capital that it will not threaten the common bond of wealth maximization. California can indulge itself because Delaware still offers the necessary safe haven for the dominant economic interests, and insider trading lacks the same level of importance that corporate law does. But if California seeks to take the approach to its logical conclusion, by systematically regulating all forms of corporate fiduciary misbehavior simply because they occur in California, the system would lose stability, and Congress would have to step in. Even though California exhibits far less concern about state primacy than Delaware, it probably would not want that outcome either, and so the issue will likely stay relatively quiet and confined.

45. *See, e.g.*, William Chandler & Leo Strine, *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953 (2003).

III. Bigger Controversies

The approach set forth above decribes the situation but does not necessarily make a normative judgment. To summarize, it describes the political economy of state-federal relations in corporate and securities law in top-down terms, noting that the division of authority reflects Congress' political preference rather than some natural order of things.

The description helps one to pose the questions that grow out of the more recent controversies properly. Once again, everyone should stop speaking of federal "incursions" into state corporation law. Congress holds the ultimate power on matters of interstate commerce, and only by congressional preference do the states have any role in regulating beyond their own borders. Putting aside questions about its wisdom, Sarbanes-Oxley is a national response to a perceived national problem. It exists as a revision of a long-standing political bargain rather than a power grab. And one could say the same about SEC initiatives. Statutory authority governs the question: how much of this policy-making did Congress delegate to the Commission, and how much did it keep for itself? "States' rights" do not exist in the relevant analysis apart from Congress' preferences. Given that the SEC acts as Congress' primary agent for holding the potential of federalization over the states,[46] a considerable degree of delegation exists. However, without a doubt, Congress wishes, for political reasons if nothing else, to keep some choices to itself.

Turning to state activity, federal preference again governs. Some securities laws reflect a policy preference that the SEC cannot deal with some—presumably localized—securities matters. Thus, state enforcement serves as a useful supplement. Because one cannot easily articulate the dividing line between what constitutes a localized or a national matter, the statutes do not limit the scope of the state action. Hence, any judicial challenge to the states' activity would have to argue that the federal government's actions have filled the field completely, which is unlikely to be true. For instance, even in mutual fund regulation, which has laws that probably exhibit the same scope as any

46. John Coates has described the SEC—in terms not unlike Roe's description of Delaware—as a way of moving issues away from the political arena where there is risk of stakeholder interference with corporate wealth maximization. *See* John Coates IV, *Private v. Political Choice of Securities Regulation: A Political Cost-Benefit Analysis*, 41 VA. J. INT'L L. 531, 534–35 (2001).

law at the federal level, courts and the SEC have long recognized the concurrent role of state law.[47]

One could argue that state laws address conduct insufficiently connected to the acting state, making them invalid under the Commerce Clause. But, with few exceptions, the states' aggressiveness has not gone that far. For example, Eliot Spitzer targeted schemes that were launched mainly on Wall Street and had significant effects there. Thus, Congress will have to be much clearer than it has been for "incursions" like Spitzer's to be impermissible.

Whether those incursions are normatively good or bad is another matter entirely. Simply from a public policy standpoint, the argument for having aggressive state enforcement beyond essentially local matters underscores Roe's point. Because Congress presumptively centralizes the matter at the federal level, it is easier for business interests to influence the regulatory process in a way that denigrates the interests of the less-well-organized—retail investors particularly. Having fifty states with potentially concurrent jurisdiction creates a check on that, and there exists reason to suspect that Spitzer and other state officials have caused the SEC to act in ways in which it would not have otherwise.

That said, however, the absence of any clear line tempts the states to overreach, especially in times of scandal when the threat of federal backlash decreases. The dangers of state criminal prosecution, especially on the fairly loose standards of something like New York's Martin Act,[48] are disabling enough to give prosecutors leverage on matters of industry conduct that those in the industry would otherwise resist.[49] Local state-level politics should not determine basic policies in the securities industry. Thus, Congress always has a principled argument for removing particular matters from state authority.

What the future will bring depends on the states. There exists some reason to believe that some state regulators value their expanded vision of the states' role for both political and economic reasons—financial settlements have produced a good deal of money as well as publicity. And now that everyone recognizes the states' role, it would be hard for the states to pull back without seemingly bowing to

47. *See, e.g.*, Burks v. Lasker, 441 U.S. 471, 478 (1979).

48. N.Y. Gen. Bus. Law § 352-c (McKinney 2006).

49. This is especially so because of the collateral consequences of a criminal conviction. For example, under Section 9 of the Investment Company Act, any adviser convicted of a securities related crime is presumptively barred from managing a mutual fund. 15 U.S.C. § 80a-9 (2006). Obviously, no major investment firm can afford that risk.

political pressure. But the states need to remember that they compete with federal regulation in a way which may be constitutionally aggressive and that, under the circumstances, Congress could change at any time. I suspect that all the relevant actors know this, and the states will judiciously stop short of triggering a backlash. Indeed, as scandals and troubles fade, less incentives will exist to press the issue in the first place. If so, the federalism tensions will quiet down, at least until the next episode of troubles and scandals arise.